S. Hrg. 101-1116

IMPLICATIONS OF THE FAILURE OF THE HIGHER EDUCATION ASSISTANCE FOUNDATION

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE IMPLICATIONS OF THE ANTICIPATED FAILURE OF THE LARGE GUARANTOR OF STUDENT LOANS, THE HIGHER EDUCATION ASSISTANCE FOUNDATION

JULY 27, 1990

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
35-771
WASHINGTON : 1991

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5241-29

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IMPLICATIONS OF THE FAILURE OF THE HIGHER EDUCATION ASSISTANCE FOUNDATION

FRIDAY, JULY 27, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 2:22 p.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Dodd, Dixon, Bryan, Kassebaum, Pressler, and Pell.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. Let me welcome all those in attendance this afternoon. We're starting a little late because the Senate is in session on the farm bill and is voting. As a matter of fact, we just finished a roll-call vote, and there may be others that might interrupt us this afternoon.

This afternoon's hearing concerns the implications of the anticipated failure of the largest guarantor of student loans, the Higher Education Assistance Foundation, known as HEAF.

We will hear witnesses from the Department of Education, GAO, and Sallie Mae. And we are grateful for their willingness to come here in the midst of a very difficult situation.

A large proportion of the loans guaranteed by HEAF have defaulted, and a continuing heavy flow of defaults is expected. Because guarantors with bad losses records receive only partial reimbursement from the Education Department, the loan defaults have led to loss at HEAF, which at some point will be unable to meet its obligations to reimburse banks and their lenders for these losses.

HEAF's failure has raised concerns among banks about whether all of their losses will ultimately be covered. If banks do not have confidence that someone will reimburse them, they may be reluctant to make new loans.

Concern has also been raised about Sallie Mae's exposure to HEAF. Since reports about HEAF's problems became public, Sallie Mae stock has declined 13 percent, and news of HEAF's problems was cited by the Washington Post as a factor in the 106-point stock market plunge early on Monday.

While these developments are serious in their own right, HEAF's failure raises perhaps even more troubling concerns about the design of Federal Government guarantee programs.

In too many cases, including deposit insurance, the Farmers Home Administration, the Federal Housing Administration, and the Guaranteed Student Loan Program—to just name a few—losses on Federal guarantees have a tendency to mount up well past levels that were earlier envisioned by even the most pessimistic projections.

In the case of student loans, we are now losing money because of defaults at the rate of about $2.3 billion a year. And the number is rising despite a series of legislative and administrative changes in recent years intended to reverse this trend.

The HEAF failure may add to the Government's losses. Once again, it appears that the Federal Government has explicitly or implicitly guaranteed risks stemming from the behavior of financial institutions over which it has little or no control.

In the case of S&L's, we let State chartering agencies expand thrift powers in dangerous areas while we maintained Federal deposit insurance. Risk involving Government sponsored enterprises, GSE's as we call them, with nearly a trillion dollars of implicitly guaranteed liabilities is another area that this committee has been examining very carefully.

Though most GSE's are currently prospering, safety and soundness regulation has been lax in the past and Government losses have occurred at one GSE.

Guarantors are critical elements of the Student Loan Program. Lenders rely heavily on their performance in processing and making payment on claims. Yet, there doesn't seem to be an adequate mechanism in place for the Federal Government to require sufficient capital or to step in more directly in the event of insolvency.

Not only does this place us in the position of possibly needing to cover losses beyond what the program was designed to cover, but it may also complicate the task of resolving the problem quickly and efficiently.

I want to say at the outset that I realize some sensitive negotiations are going on. It is not the intention of this committee hearing today to in any way interrupt or interfere with those kinds of important negotiations.

Today, on our witness list, we will be hearing from Ted Sanders, who is the Under Secretary of the Department of Education. He will be accompanied by the general counsel from that Department.

Then, by Franklin Frazier, who will be here speaking for the General Accounting Office, with persons accompanying him.

And finally, Lawrence Hough, who is the president and chief executive officer of the Student Loan Marketing Association.

Let me invite Mr. Sanders and whoever he has accompanying him to come to the table at this time.

I yield to Senator Bryan.

OPENING STATEMENT OF SENATOR BRYAN

Senator **Bryan**. Mr. Chairman, thank you very much. I think it's timely and very appropriate for you to have convened this hearing.

I'd like to make a couple of observations generally that do not bear strictly in point with the issue today, but does at least reflect a concern that I have about the Student Loan Programs generally.

I'm a very strong advocate of this program. Having had three youngsters who were all at the university at the same time together, and my former neighbor, Mr. Sanders, Nevada, and his youngsters are friends of my children. I understand that for many families it is the only way in which they can afford to provide higher education.

I think that's in the best interests of the individual. I also happen to think that the Nation benefits as a consequence.

I must say that I am deeply troubled, however, with the administration of some of these programs. I know as a former Governor the WICHE program in our own State, we had some $300,000–$400,000 in default, largely through the failure to aggressively collect those loans.

As a matter of fact, I indicated as Governor that I would release the names of all those who had defaulted. And I can tell you, within a week, 90 percent of those individuals had gotten on a repayment program.

Now, I realize the WICHE program is different from what we're talking about this morning. But, it seems to me that we have an obligation to the American taxpayer to insist upon repayment. And that we ought to be vigorous about it.

There are circumstances of mitigation, I'm sure, where illness or family matters make it extremely difficult. But, the entire program, it seems to me, is jeopardized as a result of failure to insist upon.

I'm also aware of another aspect of the program that does trouble me greatly. And that is the abuse that presently exists with respect to this. I know firsthand of instances where student loan programs have been used to invest in the stock market.

I know of another instance in which it was used to buy an expensive new automobile. That was certainly not its purpose.

I'm frankly offended by that. And I would simply give to those who are here in this audience today, who share an interest and belief that these loan programs are vitally important to provide educational opportunities for so many families because of the enormous increase in the cost of higher education, that these kinds of abuses are the very sorts of things that cause these programs to be viewed skeptically and also make them vulnerable to congressional response.

Mr. Chairman, I thank you very much.

The CHAIRMAN. Thank you, Senator Bryan.

Senator Kassebaum.

Senator KASSEBAUM. Thank you, Mr. Chairman.

I'd like to ask first that my full statement be made a part of the record.

The CHAIRMAN. Without objection, we will make it a part of the record.

OPENING STATEMENT OF SENATOR KASSEBAUM

Senator **Kassebaum**. And just express my appreciation for your holding the hearing. We will be in the Education Subcommittee holding a hearing next week to further explore this.

I think that all of us gathered here today to recognize the importance of the Student Loan Programs and what the Federal Student Loan Program has done to open access to higher education.

I think it's had an enormously important function. This hearing, in particular, of course is to address the concerns about the financial stability of the Higher Education Assistance Foundation and what impact, if any, the failure of the nation's largest guaranty agency will have on the banking and the student aid system.

I personally believe, Mr. Chairman, that, one, it's not going to be a bailout, as some have termed it; that the strength of the financial student aid system is going to remain sound. The Secretary of Education has spoken to that effect.

And I think it's important as we begin to approach the height of the student loan season that this be made perfectly clear because it is of concern to students who are making applications now wondering what the process will entail.

So I hope that the hearing today will reassure everyone that the Student Loan Programs will continue to exist and function effectively to serve its purpose of helping students get a postsecondary education.

I would just like to make a comment a bit on the comments of the Senator from Nevada.

I think that his observation regarding what has happened to some of the student loans is one that we frequently see.

I would also say that I think some of the guaranty agencies have been placed in a difficult position by being asked to guaranty loans and yet by also a large number of clients, so to speak, that have not assumed some of the responsibilities that they must assume.

I'm thinking of some of the schools that have abused their responsibility in making sure that the soundness of their program is going to be one that students can gain from and by the fact of having participated in that program can repay on their student loans.

And if there is anything that I hope will come out of this particular incident, which I'm confident will be addressed and be addressed in a way that's going to strengthen and reassure everyone that the system is sound, it will be to look at the whole of the future, where we are going with the Student Loan Programs.

And I think, for that reason, Mr. Chairman, this is a very important hearing, as I'm sure future hearings will be. And our attention certainly has been focused now on what I think could have been a growing problem if it weren't addressed.

[The complete prepared statement of Senator Kassebaum follows:]

Prepared Statement of Senator Kassebaum

Mr. Chairman, everyone in this room recognizes the importance of the Federal student financial aid programs and what opportunities these programs have been able to offer to individuals who might not otherwise enjoy them. To throw out numbers, between 1970 and 1980, enrollments in higher education institutions increased

41 percent—from 8.5 million to over 12 million students. I think we can say that the Federal objective of increasing access was successful.

The hearing before the Banking Committee today addresses concerns about the financial stability of the Higher Education Assistance Foundation (HEAF) and what impact, if any, the failure of our Nation's largest guarantee agency will have on the banking and the student-aid systems.

I would like to take a minute to reassure everyone that this is not another "bailout" as some have tried to term it. Rather, a national guarantor who was experiencing difficulty meeting their financial obligations sought assistance from others including the advice of the Federal Government.

Undue media attention has in effect destroyed the possibility of an early solution. The exposition of HEAF's problems has sent rumors flying through both the banking and student-aid communities. The Department of Education, to their credit, has tried to ensure a sense of calm among all the players in the student loan community—particularly the students.

We are nearing the height of the "student loan season." Individuals preparing to enter school in the fall are starting to flood the offices of banks and school financial-aid offices with applications for Federal student loans. These students are being out at risk by the rumors and leaks that have flowed like water through a sieve to the media. I hope that this hearing today will reassure everyone that the student loan program will continue to exist and function effectively—to serve its purpose of helping students get a postsecondary education.

I am aware that the Department is undergoing intense and very sensitive negotiations with HEAF and other entities. I have been told that, as soon as an agreement is reached, we will be notified. The Department is aware of the immediacy of this issue, and I am confident that negotiators will reach a decision in the near future putting this all to rest.

Sallie Mae will also testify before the committee today. As many of you know, Sallie Mae is a government-sponsored enterprise originally created by the Federal Government to allocate credit to borrowers of the economy. In the case of Sallie Mae, these borrowers are students.

Sallie Mae has continually strengthened its position in the business and student loan communities. They are currently a New York Stock Exchange corporation with more than $35 billion in assets and a AAA bond rating. They own close to 30 percent of all federally guaranteed student loans outstanding today—all of which are collateralized. HEAF is the guarantor for a portion of Sallie Mae's loans. However, it is my understanding that the large majority of these loans is in repayment and therefore can be expected to complete payments with a low percentage defaulting.

In the 17 years since Sallie Mae was established, it has provided over $40 billion in funds and commitments for educational loans. In education terms, this means more than 17 million student loans and several million students have been given the opportunity to pursue the American dream of a college education. It was once said that "Education has in America's whole history been the major hope for improving the individual and society." I would remind everyone to remember this thought as we press forward today.

The Subcommittee on Education is planning to hold an oversight hearing on this issue next Friday. Both Senator Pell and I have been following this issue very closely. I am confident that the Department will have finalized their negotiations with HEAF and the other entities by next Friday and will be able to discuss this problem. The subcommittee was planning to review the role of guarantee agencies in the Federal student loan program, and what to do in the event that a guarantor failed, as part of the reauthorization of the Higher Education Act next year. This incident has accelerated these plans a bit. I believe I also speak for Senator Pell when I say that it is our foremost objective to ensure the continued viability of the Federal student loan program and assure access to Federal student loans.

The CHAIRMAN. Very good. Thank you, Senator Kassebaum.

As you properly note, this, like so many issues here, is an issue that cuts across committee lines and the Education Committee has a very important role to play in this and has over a long period of time. Our effort here is to try to understand the financial implications.

I want to particularly welcome Senator Pell here today. I'm delighted that he is with us because he is truly one of the great national leaders on the issue of educational opportunity. Let me invite you to make any comment that you might want to make at this time.

Senator PELL. Thank you very much, indeed, Mr. Chairman, for your hospitality in permitting me to be here. I wanted to be here together with the ranking minority member of our subcommittee, Senator Kassebaum, myself, have an interest in the educational side as well.

I'm basically here to listen, learn. At our own subcommittee, we will be having a similar hearing next Friday at 10 o'clock, at which point I hope to use the knowledge I will have gained from this hearing to ask more intelligent questions than might be otherwise the case. [Laughter.]

The CHAIRMAN. Very good.

Senator Dixon.

Senator DIXON. Mr. Chairman, I congratulate you upon having this hearing, and I'll place my statement in the record in the interest of time.

I thank you, Mr. Chairman.

The CHAIRMAN. Very good. We'll make your statement a part of the record. I also have a statement from Senator Garn.

[The opening statement of Senator Dixon follows:]

OPENING STATEMENT OF SENATOR DIXON

Senator DIXON. Mr. Chairman, this afternoon the Senate Banking Committee continues its oversight of issues related to Government sponsored enterprises.

Late last week the Education Department reported that one of the two largest private guarantors of student loans Higher Education Assistance Foundation [HEAF], may be insolvent. I respect the chairman for organizing a hearing so quickly and hope that this inquiry will be productive.

We do need answers to a variety of questions. How serious is the situation? Is this expected insolvency lcoalized to one nonprofit institution? Is the Education Department taking steps to minimize direct and indirect risks to the Federal Treasury? What are the implications of HEAF's situation for Sallie Mae and for banks which make or hold student loans?

I look forward to answers to these questions and to the testimony of the witnesses.

Thank you, Mr. Chairman.

[The complete prepared statement of Senator Garn follows:]

STATEMENT OF SENATOR GARN

Over the last week or so, a series of stories about a guarantor of student loans, HEAF, the Housing Education Assistance Foundation, has been prominent in the news media.

Today my hope is that at this hearing we can get the real story of what's happened to this loan guarantor. I also am anxious to hear what effect recent events will have on the banks which make the student loans, and the prospects for students when need a loan in order to attend the higher educational institution of their choice.

I also want to thank the witnesses who have managed to come before us and testify with very little notice.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Sanders, we'd be pleased to hear from you now.

Mr. SANDERS. Thank you, Mr. Chairman.

STATEMENT OF TED SANDERS, UNDER SECRETARY, DEPARTMENT OF EDUCATION, WASHINGTON, DC, ACCOMPANIED BY EDWARD STRINGER, GENERAL COUNSEL, DEPARTMENT OF EDUCATION; AND LARRY OXENDINE, OFFICE OF POST-SECONDARY EDUCATION, DEPARTMENT OF EDUCATION

Mr. SANDERS. Thank you, Mr. Chairman, and members of the committee. I am pleased to appear before you today and to speak to the concerns that have been raised by the financial problems of the Higher Education Assistance Foundation, better known, as you mentioned, as HEAF. It's one of the Nation's largest guarantors of student loans.

And I would like to introduce to you two members of the Department staff who are with me—our general counsel, Ed Stringer, to my left; Larry Oxendine of our Office of Postsecondary Education, to my right.

HEAF'S FUNCTION

Under the Guaranteed Student Loan Programs, Mr. Chairman, administered by the Department, HEAF operates as the designated guarantor in Minnesota, West Virginia, Kansas, Nebraska, Wyoming, and the District of Columbia.

It also operates as a national guarantor insuring loans in other States where a different agency is the designated guaranty agency.

In 1989, HEAF insured loans for some 1,147 lenders, and as a guaranty agency, HEAF's function is to insure loans made by lenders to students, to pay their insurance claims on defaulted loans, and to service and collect those loans.

As you know, the Department has been notified by HEAF that it's facing serious financial problems. And, given the imbalance between revenues and costs, it's doubtful that HEAF will be able to continue to pay default claims presented by lenders in the near future.

HEAF'S FINANCIAL PROBLEMS

Mr. Chairman, HEAF's financial problems stem in part from, first, a portfolio with a high percentage of loans to students at proprietary schools with high default rates; second, efforts by HEAF to adjust its portfolio since 1988, which have resulted in HEAF ceasing insurance operations in some 18 States, with a resulting reduction in its revenues.

We've been charting HEAF's efforts to improve its loan portfolio mix with an expectation that its current financial problems could be avoided.

However, we have learned from HEAF only in the past 3 weeks that the default rate for its proprietary school loans has increased and that the adjustments in the portfolio have not succeeded in avoiding a financial crisis.

Now, the Department, in conjunction with the Office of Management and Budget, is closely monitoring this situation and is developing options to resolve the matter in the event HEAF is unable to continue to meet its responsibilities as a guaranty agency.

We have today a nine-member team on site at HEAF's headquarters in St. Paul, MN. That particular group includes accounting and computer specialists who administer our Student Loan Programs. They're monitoring HEAF's operations. They're assessing the situation firsthand to assist us in making informed decisions about HEAF's existing loan portfolio and its prospective guaranty functions.

In addition, we are also intensely involved in sensitive discussions with other agencies that might have an interest in and capacity for assuming all of HEAF's guaranty functions.

We've made, Mr. Chairman, our position clear in public as well as with the Congress. I'd like to repeat again the position that we hold. I could not emphasize strongly enough that despite some alarmist reports in the media, the situation will not affect the ability of students to obtain loans, of lenders to make those loans, or of guarantors to insure those loans.

HEAF's problems are serious to that organization, but they do not threaten the integrity of the nationwide Guaranteed Student Loan Programs.

HEAF'S OBJECTIVES

Our objectives at the moment are, first, to minimize the cost to the taxpayer, if any.

Second, to review the quality of HEAF's program administration.

And, last, to study the situation carefully for any lessons which may be learned so as to ensure a stronger Student Loan Programs; and to act decisively to arrange for an orderly management of the HEAF portfolio.

While we take these problems very seriously, analogies of this situation to the savings and loan crisis are quite simply inappropriate. We do not expect the domino effect from HEAF's problems. We do not see the need for a Federal bailout of guaranty agencies in general, or of HEAF in particular.

I'd stress again to you, Mr. Chairman, and members of the committee, that the Department has been taking vigorous action to address the high default rates on student loans, particularly in the proprietary school sector; that is actually at the heart of this problem.

Last year, Secretary Cavazos issued regulations that imposed significant restrictions on schools with high default rates, including possible termination from the program.

We've also been working with Congress on legislative matters addressed to this problem.

I'd like to thank you very much, Mr. Chairman. We are here to answer your questions. If I might, I'd like to just call your attention very briefly in closing to the chart that's on the easel and which you have attached to our testimony today to give you just a quick point of reference as to where guaranty agencies fit into the situation that we're discussing.

You'll notice from the chart that of course a loan originates from a student desiring to further his or her education, who, in turn, goes to a lending institution to secure a loan in support of that education.

That loan, in turn, is guaranteed or insured by a guaranty agency. The lending institution may sell that paper into a secondary market; the guaranty follows that paper as it's sold into the secondary market.

When a student defaults on his or her loan, the lender is paid by the guaranty agency at 100 percent of the value of that loan.

The guaranty agency is, in turn, reinsured by the Department of Education. And in any given fiscal year, the agency is paid 100 percent for all of its loans in default up to 5 percent of its experience.

Between 5 and 9 percent, it is paid at 90 percent. And, beyond the 9 percent level, it is reinsured or paid at 80 percent.

And so a particular guaranty agency's experience may see it being reimbursed at points during the fiscal year at 100 percent, 90 percent, down to 80 percent of the value of the loan, depending upon the default experience of the portfolio.

I'd stop there, Mr. Chairman, and my colleagues and I are ready to answer any questions that you or the committee might have.

The CHAIRMAN. Well, I appreciate your statement.

One of the policies of this committee in the time since I've been the chairman, which is now about a year and a half, is that any time a matter arises of this potential magnitude, where there can be a liability accruing to the Federal Government, we're going to get it out into the light of day and examine it. We want to make sure that we fully understand the financial ramifications and what is needed to protect the Government itself, and the taxpayers ultimately, from risk in that area.

Let me ask you some questions in that regard.

Are there other guarantor agencies that are currently in a weak condition?

Mr. SANDERS. Mr. Chairman, we believe that there may be five to seven other guaranty agencies that are in a weakened condition. The magnitude of their problems does not approximate that of HEAF, HEAF's being the result of its size. And, in fact, if you were to take their full loan portfolios, add them together, they would still be less than half of that of HEAF. None of those are in the same situation though that HEAF is in today and on the verge of not being able to pay claims to lenders.

The CHAIRMAN. I'd like to review again with you and have you be as specific as you can as to what are the primary causes as you see it of HEAF's failure.

PRIMARY CAUSES OF HEAF'S FAILURE

Mr. SANDERS. Well, first of all, Mr. Chairman, as I mentioned before, we believe that at least in part, the problems that HEAF is currently facing is as a direct result of the mix in its portfolio.

In 1988, HEAF had some 59 percent of its portfolio in proprietary school loans. They had recognized this problem, were in the process of changing that mix, as I mentioned in my testimony. By 1989, that mix was down to 35 percent in proprietary schools.

Second, HEAF made decisions that would reduce the size, the volume of its business annually, which also then reduced the fees that they were receiving from guarantees, which also altered their financial position.

The CHAIRMAN. Now, I think for the record and for those who may be watching on television, you should describe what proprietary schools are.

Mr. SANDERS. Yes, sir. Mr. Chairman, a proprietary school is a nonpublic, for profit institution offering education generally at less than the associate or baccalaureate degree. They're vocational trade school programs, generally.

The CHAIRMAN. And so these might be? Give us a range of the kinds of programs that are out there that would fall into that category.

Mr. SANDERS. Well, they could range, Mr. Chairman, from a school of cosmetology to truck driving to programs basically that could be of 3 months duration, and up, in fact.

The CHAIRMAN. And to what do you tend to attribute the much higher default rate of student loans that attach to proprietary schools than other schools?

Is it that some of these schools are not providing much in the way of a real educational curriculum? Or, is it that the student profile is such that those students are not able to earn enough to be able to repay loans?

What is there in that part of the default picture that we should understand about the nature of why the failure rates are higher there?

Mr. SANDERS. Could be a mixture of reasons, Mr. Chairman. It could be having to do with the profile of students who are enrolled and attending in those schools. They tend to be of higher risk.

It could also be, as you mentioned, in the quality of training that is offered to those individuals.

The CHAIRMAN. Now, there were some reports earlier this week that I think left some confusion in the minds of some about the quality of the guarantees to lenders that they will be repaid for losses on student loans.

And as I understand your testimony today, you are assuring us that lenders making new student loans for this coming fall semester, if they meet their responsibilities, they'll be repaid for any default losses.

Is that a correct reading of what you're saying?

Mr. SANDERS. That's correct, Mr. Chairman. We're assuming that an option can be worked out that another agency or other agencies would assume the responsibilities as guaranty agency in place of HEAF, and there should be no problems in guaranteeing loans to students.

The CHAIRMAN. And with respect to losses on loans that are currently insured by HEAF, does that same guaranty apply there?

Mr. SANDERS. Yes, Mr. Chairman, we do believe that we will have a guaranty agency or agencies in place that will assume the functions of HEAF and that those loans will be, indeed, secure.

The CHAIRMAN. Do you have a way of estimating now, within even a range, how much liability there may be from just this case that will come back on the Government here?

Mr. SANDERS. Well, as I indicated to you earlier in the testimony, Mr. Chairman, our first purpose of course is to work out a solution that protects the taxpayer. And we hope that a solution can be affected that would be one of no cost to the taxpayer.

However, there may be some requirements in the options that we're looking at that would have costs. But, we believe that they would be less than $100 million in the HEAF case.

The CHAIRMAN. Well, I take it that what you're saying is that this is a somewhat fluid situation and you're still working on the situation, but that's your best estimate at the moment as you sit here in this room.

I'm just wondering if there is any material likelihood that that number could change and enlarge.

Mr. SANDERS. No, Mr. Chairman, we believe that would be the outside number, even beyond the outside number, that we would be looking at in the HEAF case.

The CHAIRMAN. Can you tell me when the Education Department first learned of HEAF's difficulties?

Mr. SANDERS. Well, Mr. Chairman, we had known from reports sometime ago that HEAF was experiencing some problems in its portfolio mix. They had disclosed that to us. We had every expectation, as did they, that the steps they were taking to alter the mix in that portfolio would solve their problems.

It's been within the last 3 weeks that we have own knew that those problems were such that their ability to sustain themselves was in danger.

The CHAIRMAN. Can you tell me what authority you have to regulate or supervise student loan guarantors. And, for example, can you set capital standards?

CAPITAL STANDARDS

Mr. SANDERS. No, sir. We cannot. There's nothing in the law that would provide the authority for us to do that.

The CHAIRMAN. Do you think there should be?

Mr. SANDERS. I think that may be one of the options, Mr. Chairman, we may want to look at out of this experience, along potentially with others about which we probably will learn.

The CHAIRMAN. You know, with Government sponsored enterprises that we are examining this year in this committee, one of the principal questions is this issue of capital standards. We're visiting that in all areas where the Government has either a direct or a contingent liability. I think, just as a general proposition, if we're going to have the taxpayer on the hook at any stage in the process, the issue of capital standards is something that we have to get up front and center and establish pretty clearly.

I want to reserve a judgment on that. And you're suggesting that you want to look at that, too, and you may have something to say about that at a later time. But I think that is a question that we're going to have to make sure we've got a very clear answer to by the time we work through this problem.

Let me just ask a couple of other things and then I want to yield to Senator Kassebaum. And that is:

What does the Education Department do now? How are you geared to actually monitor and audit guaranty agencies of this kind?

OVERSIGHT OF THE GUARANTY AGENCIES

Mr. SANDERS. Basically, Mr. Chairman, we perform four tasks in exercising oversight of the guaranty agencies.

First of all, we conduct with our staff program reviews that look at the agency's compliance with the law itself and rules and regulations of the Department of Education.

Our inspector general conducts audits of those agencies.

Third, we review in-house the audits guaranty agencies that are performed by independent audit firms.

And we also require and review, do desk audits of, quarterly reports that are provided to us from those agencies.

The CHAIRMAN. When would have been the last time, for example, that HEAF was audited?

Mr. SANDERS. Their audit, Mr. Chairman, was last performed I believe in 1988 or 1987. That is, a departmental audit—1988, Mr. Chairman.

The CHAIRMAN. 1988. So this would have been 2 years ago? Is that right?

Mr. SANDERS. Yes, sir.

The CHAIRMAN. And is that about par for the course? Every couple of years?

Mr. SANDERS. They're scheduled every 2 years, Mr. Chairman.

The CHAIRMAN. I'm wondering if that frequency is sufficient. I'm wondering if, in light of even this example, we ought to be taking a look more often than that.

What's your thought on that?

Mr. SANDERS. Well, certainly, it would do no harm to look at this option; 2 years though seems reasonable in terms of an audit cycle of an agency like this, especially when we have access to the independent auditor's report. That is also a compliance audit.

More importantly, I would place my attention, I think, Mr. Chairman, on the ongoing monitoring and program reviews that is where we probably should be focusing more of our attention.

The CHAIRMAN. But, didn't I—if I heard you right, didn't I hear you say a minute ago that it really wasn't until about 3 weeks ago that you knew you had a serious problem here?

Mr. SANDERS. We knew we had a problem, Mr. Chairman, but we did not know the magnitude of that problem and that HEAF's collapse might be imminent, until about 3 weeks ago.

The CHAIRMAN. You see, I think that leaves the question in the air:

Is our monitoring procedure adequate?

I mean, you obviously got caught in a sense by surprise. And that normally would suggest that we ought to have some other way of keeping track of things so, if there is a deterioration, that we spot it earlier so that we get something more than 3 weeks notice.

Isn't that a fair observation here?

Mr. SANDERS. Yes, Mr. Chairman. However, if we had been doing an audit, that audit might not have picked it up and flagged it for us in time either.

The CHAIRMAN. Thank you.

Senator Kassebaum.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Mr. Sanders, I'd like to ask first is there a provision in the Higher Education Act which would allow the Secretary of Education to make a formal request to Sally Mae to give funds to a guaranty agency?

Mr. **Sanders**. Make a formal request to them to directly give funds?

Senator **Kassebaum**. Yes, to provide funds to a guaranty agency.

Mr. **Sanders**. I'd like to ask Mr. Stringer, since that would really be a legal question, Senator, if I might, for his response.

Mr. **Stringer**. I don't know of any authority that the Secretary would have in that respect, Senator.

Senator **Kassebaum**. I have a question that another Senator wished me to ask.

Could you outline the obligations of the Department of Education, the lender institutions, the students, HEAF and the general taxpayer if HEAF were forced to declare bankruptcy?

Mr. **Sanders**. The obligations, Ed, that probably would be better responded to by you.

Mr. **Stringer**. Starting in order of the question——

Senator **Kassebaum**. It's kind of a long one. It's sort of the obligation of everybody.

Mr. **Stringer**. The Federal Government has no direct obligation to the lenders. The only obligation of the Federal Government in the program as it's now constituted is to honor on a reinsurance basis the claims put to the Federal Government that the guaranty agencies have properly honored to their lenders.

So there is no direct connection with the lenders.

To the guaranty agencies, it is the responsibility as I outlined.

To the students, the Department has no direct obligation.

To the taxpayers, obviously, we have a very direct obligation to fulfill the responsibilities of the Department under the program.

Mr. **Sanders**. We do have some—if I might add—we do have responsibilities to the student to see that there are lenders available in each and every State.

LENDER OF LAST RESORT

Mr. **Stringer**. Certainly. There is a concept of lender of last resort which provides that, in every State, there shall be a lender available to a student, notwithstanding that student's credit capability. And in States where the guaranty agency, where a guaranty agency is designated, that guaranty agency is automatically the lender of last resort.

And that lender has no discretion to turn down a loan application from a student.

Senator **Kassebaum**. Do you mean, if there is difficulty with the initial loan?

Mr. **Stringer**. Correct.

Senator **Kassebaum**. In finding a new lender, they have to assume that responsibility?

Mr. **Stringer**. Yes. If a student wants a loan and the student has insufficient credit qualifications at a commercial bank, the student could go to that lender of last resort and obtain that loan.

Senator **Kassebaum**. Is that true with every instance?

Mr. STRINGER. Yes. In every State.

Senator KASSEBAUM. In every State, when a student wishes to make the initial application for a student loan and there is no line of credit—certainly, one can understand that. But, a lender of last——

Mr. STRINGER. A lender of last resort.

Senator KASSEBAUM [continuing]. Last resort has an obligation to provide that loan?

Mr. STRINGER. That's right.

Senator KASSEBAUM. Then, who is responsible when that defaults?

Mr. STRINGER. The guaranty agency is responsible to pay that lender and the Federal Government is responsible on a reinsurance basis.

Senator KASSEBAUM. Well, you see, this I think is sort of the nub of the problem because we're expecting, one, the lender of the last resort to assume loans that there is certainly a question whether they'll be repaid.

And the guaranty agency is also having to assume a responsibility in that instance as well.

And I really feel that we're going to have to sort through what the role of the lender and the guaranty agency is when they have to assume loans which may be questionable.

And this is going back to, again, some of the difficulties that have arisen with the lenders and with guaranty agencies that have had to assume loans that have been questionable, and some other agencies that maybe don't have to take those risks, or guaranty agencies.

And I don't know quite what the answer is. But, I clearly believe at some point we are going to have to be much tougher in either making a requirement that there is a better monitoring of the system, to begin with, initially, or else there's got to be a better guaranty if we're requiring the lender of last resort to assume this and yet make them responsible for cleaning it up.

That, clearly, if I'm reading this correctly from what you're saying, is a real problem.

And it seems to me if, under law, we are requiring them to do that, then the Government has some responsibility to help them out.

Mr. STRINGER. Well, that is what the law provides.

Senator KASSEBAUM. That's all the questions I have right now, Mr. Chairman. I've got to think that through for a moment.

The CHAIRMAN. You reload and we'll give you another round. [Laughter.]

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

I apologize. I was out of the room during the colloquy that the Chairman had with you, Ted, and with you, Mr. Stringer.

I want to follow up a little bit on where Senator Kassebaum was coming from.

Obviously, if the quality of the loan is bad in the first instance, the risk is greater. And as Mr. Stringer has explained the law, each successive event is required by law; namely, that there be a lender of last resort, that there be a guaranty. And that, ultimately, if the guaranty association-organization fails, there is a fall-back position which, under the reinsurance obligation, as I understand it, comes to the doorstep of the Federal Government.

I want to again reemphasize the point that I made earlier:

I am a strong supporter of student loans. I mean, I think it's vital in the national interest.

But, clearly, the quality of these loans and the monitoring. Now, from the information provided us by the GAO, it indicates that this program has expanded enormously in recent years. To quote, "between 1983 and 1989, loans grew from about $7 billion to over $12 billion annually, and 83 percent increased."

Now, let me indicate that doesn't give this Senator any heartburn. If more students are getting opportunities to provide for themselves and their families and their future greater educational opportunities, I applaud those efforts.

It indicates similarly the number of loans increased from 56 percent, from $3 million to $4.7 million.

And that, too, I'm very pleased with.

But, here is the one that I find absolutely shocking. And the point I think that Senator Kassebaum was directing a point, during the same period—now we've had increase of the total amount of loans from $7 to 12 billion in a 6-year period of time—the number of loans increasing by 56 percent, from $3 million to $4.7 million, the defaults increased by a rate of 352 percent.

Now I must say that I don't have a good background in accounting, but as you and I have talked, Ted, so many years back, when you were the Superintendent of Public Instruction in Nevada, whether you learned under the old math, as you and I did—[Laughter.]—or the new math, that's a sorry record.

Share with me, if you can, an insight into what's causing that? And focus it, if you will, to make it more appropriate to the focus of the hearing as the chairman has convened it.

LOAN DEFAULTS HAVE INCREASED SUBSTANTIALLY

Mr. **Sanders**. I might, Mr. Chairman, Senator Bryan, comment that we've had—to concur with your statement there—we've actually had proposals before the Congress that would require things like a credit check and a cosigner for these loans to improve the default situation.

As I mentioned in an earlier response, there is a combination of things that are taking place here, one of which we do have numbers of high-risk students who do take loans and who do avail themselves of opportunities to go on to further their education, as well it should be, as you stated.

That creates a risk for default.

Also, Mr. Chairman, Senator, there's no question that there are institutions out there that provide less than effective training and, therefore, leaving students without the necessary skills, do help to contribute to a default situation.

Larry, you may want to add.

Mr. **Oxendine**. With respect to the substantial increase in the default percentages over time, I would add that the defaults that we are receiving in any one year are really defaults on loans that were paid in previous years.

We saw a substantial increase in the loan volume over the last 5 or 6 years. And now I think we are seeing the result in default volume because the defaults now are really catching up with the loan volume that we saw in the past.

Senator **Bryan**. Well, let me make the observation at least of one Senator, although I may be, as my kids remind me, in the autumn of my life, the twilight of my years——

The **Chairman**. Let's hope not. Let's hope not. Let's hope you're in the spring.

Senator **Bryan**. I hope they weren't referring to my Senate career, Mr. Chairman. They may very well have had reference to that as well.

But, clearly, trying to put ourselves back in that timeframe when all of us were trying to get an education, an 18, 19, 20, 21-year old kid is not going to have a line of credit. He and she is going to, by and large, have virtually no experience at all.

So I would hope that, in trying to reduce the default rate, we don't put that burden solely upon that youngster that's trying to get the loan.

It seems to me that there are various postsecondary educational programs that would be of the training and technical school nature that have a very high incident rate of failure, which suggests that there may be more interest not in providing an education, but in taking the money that can be provided.

It seems to me that we ought to be meaner than the proverbial junkyard dog when we find that kind of stuff occurring.

And, second, it seems to me the responsible educational institutions in this country—and there are indeed many. I cite the example that sent me absolutely ballistic, is that our WICHE Board, Ted, as you may recall, that there was $300,000 or $400,000 out there in default, had never made a demand. Had never said:

Look, you got this loan before you went to vet school, before you went to medical school, before you went to law school.

Never made a demand.

Now I can tell you what I did. We replaced the board. You're gone. You're history. You have an obligation to keep this program solvent and responsible. And I think educational institutions, would be my point, have an obligation to make sure that, indeed, to the extent that they have some responsibility here, to honor that.

Share with me your thoughts in terms of that aspect and what part of the problem, if any, you attribute that to.

DEALING WITH DEFAULTS

Mr. **Sanders**. Mr. Chairman, Senator Bryan, the Secretary, too, has been concerned about and has taken aggressive steps during his watch to deal with the problem of defaults. First of all, within the authority that we currently have in law, we've taken a number of steps, some of them very principally aimed at institutions with high default rates. These include requiring management plans and taking sanctions against the institutions after their default rates reach a certain percentage.

We've been aggressive there. We have brought forward also to Congress——

The CHAIRMAN. Mr. Sanders, let me just stop you. I hesitate to do so, but this is an important answer and I don't want it to be squeezed down to too small a size. I think we need to continue with this line of questioning. We're on the second bells and I think we may run out of time for the vote.

Maybe what we should do is just adjourn right in the middle of your answer and pick right up there when we reconvene in just a matter of minutes.

Mr. SANDERS. That would be fine.

The CHAIRMAN. The committee will stand in recess for about 10 minutes.

[Recess.]

The CHAIRMAN. Let me invite everyone in the room to find a seat so that we can resume. We cut that vote very close, Mr. Sanders, in terms of the timing.

I would like to resume with Mr. Bryan, with where we were when we had to take the recess to vote.

Senator Bryan, do you want to just allow the witness to continue, or do you want to rephrase the question?

Senator BRYAN. Knowing Ted Sanders as I do, Mr. Chairman, he will recall precisely where he was when the gavel fell. And I am sure that his syntax will not be garbled in any fashion and it will just kind of read like a good novel.

So, I will defer to Ted, unless he wants me to reframe the question at all.

Mr. SANDERS. No, Mr. Chairman.

Senator, I would be pleased to continue. I don't know that I can live up to that expectation, however. I was describing for you a number of the aggressive steps that we are taking as a part of the default initiative enacted by Secretary Cavazos just over a year ago.

I had mentioned to you that we had taken aggressive steps to deal with those schools with high default rates. We have staged that at various points, with schools that have default rates, Mr. Chairman, and Senator Bryan, of over 20 percent being required to submit default management plans that get to the root causes of the defaults in those particular schools.

When a school goes beyond 30 percent, it must delay the actual disbursement of loans to first-time borrowers for some 30 days, and we also require those schools to have a pro rata tuition refund policy.

And once the default rates get beyond 40 percent, we initiate suspension and termination actions against those particular schools.

We have also required schools to counsel first-time borrowers directly so they understand the responsibility they are assuming by taking out a loan.

We are also requiring that schools offer to students, actually disclose to those enrolled in nonbaccalaureate vocational programs, information that could be used by students as consumers regarding program completions and job placements. This information becomes very, very important in the students' decision-making process about where they should go for their education or their training.

We also have strengthened our compliance reviews of lenders and schools. And thanks to authority that you have clarified, that the courts said we did not have, we now have clear authority to take emergency actions to move against schools and against lenders and, on an emergency basis, suspend their participation when they are found not in compliance.

Over on the collection side, Mr. Chairman, Senator Bryan, we have made aggressive efforts in getting defaulted loans into repayment.

In fact, the Federal Government in this respect with the Guaranteed Student Loan Programs has a very, very good record. We do a match of Federal employees, and since 1982, some 60,000 Federal employees have been identified and sent notices to pay their defaulted student loans.

We now have, as you know, the IRS offset provision, which allows us to collect tax refunds. And we have done that on some $1.2 million in accounts. And we are not hesitant also, Mr. Chairman, Senator, to refer problems to the Department of Justice for litigation.

Additionally, our inspector general is devoting his staff a significant portion of his staff's time to audit investigative work regarding schools, particularly those with high default rates.

And we are not hesitant to move even in the courts against those with problems.

Senator BRYAN. Ted, is there a pattern of institutions by function? And I am talking about academic versus trade, or technical, in which the default rates appear to be higher.

And if so, is that information available so that the members of the committee might have a chance to look at that. I'm not expecting you to recount all of the default rates.

But there is a pattern. Tell us what the pattern is.

Mr. SANDERS. There is a pattern and we can give you that detailed information. Generally, 4-year institutions have much lower default rates than do the proprietary institutions.

Senator BRYAN. Now, there have been critics of the Department, and this predates your arrival there because this audit represents an 1983 to 1989 period.

That during the eighties, the number of program reviews and audits conducted by the Department of Education was reduced sharply. Institutionally, do you have any way to respond to that?

This predates your term, Ted.

REDUCTION OF PROGRAM REVIEWS AND AUDITS

Mr. SANDERS. Senator, I have looked very carefully at that, as has the Secretary. It is a pattern that tracks with our salary and expense accounts, which determine the number of individuals that we have on the payroll, and that can be allocated to work.

We have identified that particular problem and, in fact, have allocated greater staff resources from the salary and expense moneys that you have given to us, to this particular area of our operation, increasing the number of program reviews that we were able to conduct.

Senator **Bryan**. I take it from your answer, and I don't want to put words in your mouth, that the number of those audit and program reviews did, in fact, decline in the 1980's for the reasons that you——

Mr. **Sanders**. That is correct.

Senator **Bryan**. Would you acknowledge that that is a contributing part of the problem?

Mr. **Sanders**. I mentioned in one of my earlier responses that I do believe that strengthening the program monitoring function is something that is absolutely necessary here.

And that, yes, as we are able to do effective program monitoring with our staff, we will even more avoid these kinds of problems in the future.

Senator **Bryan**. I am sure this committee as well as the other committees that have jurisdiction over this certainly appreciate your thoughts and that of the Secretary in terms of where those resources are needed because, ultimately, the taxpayer is going to pick up the tab here.

Some have indicated that it may reach the magnitude of a couple of billion dollars a year that may or may not be accurate. I don't know. But, that is important for us to know.

And, finally, the light is on and I will yield my time, Mr. Chairman, with this one last question, if I might. And that is:

The way the schools that are eligible for participation are chosen is, as I understand it, there are accrediting associations. And they, in effect, submit to the Department schools which are eligible to participate, but that the Department itself doesn't make an individual judgment with respect to the individual schools.

In fact, it yields or defers to that accrediting association.

Am I correctly informed on that?

Mr. **Sanders**. Fundamentally, that is correct. However, the Secretary does have statutory authority to recognize those accrediting associations that will be used or recognized in this process.

There is another part. And the accrediting associations lack responsibility here because schools, just as they must be accredited by an accrediting authority recognized by the Secretary, must also be licensed by the State in which they are domiciled.

So there are two places I believe for us to look in improving oversight of the quality of institutions that qualify for the loan programs.

Senator **Bryan**. Ted, it would be helpful I think to this committee if you would make available to us the accrediting associations and their track record. That is, the defaults that occur with respect to those institutions which they, in effect, are recommending and which you acknowledge by and large. It is the association's recommendation, without any independent determination of the Secretary.

And I am not here trying to lay a wrap on the Secretary. We can debate the wisdom of that policy.

What I am interested in is the history of that. That is, if there are associations which have a good track record in terms of their recommendations, we need to know that. On the other hand, if there are those associations whose track record is deplorable, maybe a question arises as to whether they ought to be in the association business, at least as far as the Secretary of Education is concerned.

Mr. SANDERS. We appreciate that and we will provide the information.

The CHAIRMAN. Let me get a clarification before going to Senator Dodd on this.

Does each State have its own? Do we have 50 of these? Or are there larger amalgamations?

Mr. SANDERS. There are larger amalgamations. In fact, there are two different sets of institutions working here.

The States have their own State licensing requirements. Each State does that in the manner that it determines in deciding who will or will not provide education or training.

The accrediting associations are independent. They exist generally as associations of schools. They have standards which they apply to institutions who wish to belong to that particular——

The CHAIRMAN. Does this cover the whole country?

Mr. SANDERS. Some cover the whole country. Some are regional. Some are particular to a type of training or education, too.

Senator BRYAN. Mr. Chairman, I did not want to usurp the authority of the Chair. But, if the Chair feels it would be helpful, that information that I suggested be made available, namely, the default record of the institutions and the proprietary institutions or organizations—trade, technical and other kinds of schools—I think might be helpful for us to examine.

And also the track record of the accrediting institutions.

But I certainly did not mean to usurp your authority, Mr. Chairman.

The CHAIRMAN. I wanted to add to it. I want to make sure that we understand the scope of these various associations that do the accrediting.

The losses have jumped here a billion dollars over a 2-year period of time if you look at the projections for 1990 versus 1988 of what we are eating at the Federal level.

So this is not an insignificant item.

Senator Dodd.

Senator DODD. Thank you very much, Mr. Chairman.

Before he leaves, because I understand he may be walking out, I didn't want to miss the opportunity to say what a pleasure it is to have Senator Pell with us.

No other person, with the possible exception of Bob Stafford, who has retired from the Senate, is responsible for the essence of this program. And I know, in my own State and it is true across this country, that literally hundreds of thousands of young people in this country of ours who have had an opportunity for higher education have had that opportunity because of Pell grants and Stafford student loans.

And in addition to that, Senator Pell has done a number of other things, including authoring two major default reduction measures.

I serve on the subcommittee with the Senator in the Labor and Human Resources Committee, in addition to serving this committee. So I am very anxious to see how these hearings proceed.

But I didn't want to miss the opportunity of sharing with Senator Pell what a remarkable record he has established—I always teased Senator Pell and Bob Stafford. I call the firm of Pell and Stafford, Stafford and Pell, for that tandem of leadership in the minority and majority, depending on which year you were talking about. They really forged so many important educational efforts in this country.

OPENING REMARKS OF SENATOR PELL

Senator PELL. Thank you very, very much for your nice thoughts. And I must say, the 20 years that it has been either Stafford, Pell or Kassebaum and Pell or Javitz and Pell, that we have had really no partisanship in it, including when we had people of somewhat different viewpoints, like Peter Dominick. And we always really put the national interests first.

So, I thank you for your kind words. And thank you for letting me sit in for a while.

Senator DODD. I want to focus, if I can, on the program review issue with Mr. Sanders.

You seem to be implying that the law is somehow flawed. And my sense of it is, that there are other factors. First, we went from a program that was about 70 percent, a grant program, and 30 percent loans.

In the last decade, we have changed that. It is now almost the reverse. With a 30 percent grant and 70 percent loan, portfolio.

That was the fundamental philosophical change. It was decided that we were going to go to the credit window. Middle income families are going to the credit window where, in the past, we had decided that it made more sense to provide them grants.

There were fiscal issues that contributed to that change.

When that occurred, of course, in December 1987, hearings in the Labor and Education Committee revealed that the number of program reviews conducted by the Department of Education dropped from 1,997 in the period in 1981 to half that number in 1986.

So, at the very hour when we were moving from grant to loan, at a time when you would have assumed that we would have increased the number of inspectors, or increased the program reviews to monitor these programs, the Department did just the opposite.

The Department of Education cut in half the program reviews at a time the loan program.

Now, the program reviews, of course, are vitally important. So, first of all, I would like to get some sense, if I could, from Mr. Sanders on whether or not you would provide for the record the number of schools, the lenders and the agency's reviews conducted between 1980–90, so that we pick up the information for last 2 years because program reviews do have an effect in determining where the problems are involved.

Second, if you could provide information on the Department of Education's budget request for salaries and expenses.

Obviously, again with the switch occurring here, it would seem to me that there would have been a demand for increased salaries in order to hire the personnel in order to do the work that needed to be done in those areas.

Third, Mr. Chairman, again, the implication is somehow the law needs repairing here. One of the things that we have done is, of course, the LS&T approach here to limit, suspend or terminate schools, institutions where there are abuses.

That is the law. It has been the law for some time. That's not new.

I wonder if you might share with us today how many LS&T's procedures the Department has implemented in the last 2 years?

There are some 8,000 institutions, across the country.

Mr. SANDERS. Mr. Chairman, we have taken such actions. I cannot give you the exact count. Perhaps Larry Oxendine from our program staff can do that.

Senator DODD. Do you have an idea?

Mr. OXENDINE. I don't have that information with me.

Senator DODD. Just a ballpark figure.

Mr. OXENDINE. I really don't know. I can provide the information for the record.

The CHAIRMAN. Wait a minute. I want to be cooperative, but there are staff people here and we have phones in the back. Let's get the answer now.

I don't mean to stop the proceeding to get it, but let's have somebody make a call so that, in the next 10 minutes, we can have it.

Mr. OXENDINE. Then we will get it.

Senator DODD. I appreciate that, Mr. Chairman. We passed three major default reduction bills in the last 2 years. Does the Department support those legislative efforts? Those bills?

We have had three bills come out of the Senate.

Mr. SANDERS. Yes, we do.

Senator DODD. You are a strong supporter of that legislation. That is very helpful.

I would be very interested to see how many LS&T's of the 8,000 schools we have invoked here because that will be indicative of where we are headed here.

Let me turn to you, or to Mrs. Kassebaum.

The CHAIRMAN. I will turn to Senator Kassebaum, but I want to check out a number first and then pass the ball down the table to Senator Kassebaum.

According to the data that the Department of Education gave for the budget justifications, which went to the Budget Office, if I am reading the data correctly, the Federal obligation for defaults—in other words, the amount of unpaid bills that worked their way back to the Government and to Federal taxpayers—in fiscal year 1988, for example, is shown to be $1,392,000.

You may have this data in front of you. In fact, this may be one of the sheets that you brought with your presentation.

Then the number for fiscal year 1988 went up to $1.840 billion, and is estimated for 1990—I do not know if the estimate has now changed, but the estimate that shows on the sheet that I have is a figure of about $2.3 billion. Do these appear to be accurate numbers?

Mr. SANDERS. They do not coincide exactly with my numbers, but they are close to the numbers that I have.

The CHAIRMAN. What would you have for fiscal year 1990 as an estimate?

Mr. **Sanders**. For fiscal year 1990 we are looking at $2.4 billion, Mr. Chairman.

The **Chairman**. $2.4 billion. So is the figure that I have for fiscal year 1988 correct, $1.392 billion——

Mr. **Sanders**. For fiscal——

The **Chairman** [continuing]. 1988.

Mr. **Sanders**. For fiscal 1988, we have $1.389 billion.

The **Chairman**. OK. So, very close. But in any event, that is a billion dollar increase over a 2-year time period.

Mr. **Sanders**. That is correct.

The **Chairman**. Now I think that is what is the matter of concern here. We are all here to want to try to get as many appropriate student loans out to students in the country as we can, but to have net losses go up by a figure of a billion dollars over a 2-year span, implies a pretty rapid rate of increase. And of course that seems now to be part of the story that we are trying to get clear in our minds today with respect to the default situation with one of the guarantors here.

Senator **Dodd**. Mr. Chairman, may I ask one additional question here that we may want to get, as well, while the phone calls are being made? The General Accounting Office, as I am told, has said that there are some nine Department of Education Offices with responsibilities for monitoring the Student Loan Programs. Is that correct?

Mr. **Sanders**. Are you referring to the regional offices?

Senator **Dodd**. To the GAO. Nine Department of Education Offices with responsibility for monitoring the student loan program. No?

Mr. **Sanders**. No.

Senator **Dodd**. I am quoting a GAO report.

Mr. **Oxendine**. If you count each of our regional offices out in the country——

Senator **Dodd**. Are there nine?

Mr. **Oxendine** [continuing]. We have 10 regional offices.

Senator **Dodd**. Ten?

Mr. **Oxendine**. Yes.

Senator **Dodd**. All right.

Mr. **Oxendine**. Well, actually we have the GSO function in I believe it is seven of those regional offices, plus Washington, plus the IG. That is the way you would come up with nine.

Senator **Dodd**. But they go on to further state—and I am just quoting them here—that there is not a single data base where information on all these schools is kept.

Mr. **Oxendine**. Actually we have developed such a data base in the last year or so.

Senator **Dodd**. So it is now in place?

Mr. **Oxendine**. Yes.

The **Chairman**. It covers the whole country?

Mr. **Oxendine**. Yes, sir. All of the program reviews done across the country are eventually sent in to Washington to one location, and we do have a central data base for that information.

The **Chairman**. Well, we may come back to that.

Senator Kassebaum.

Senator **Dodd**. Thank you, Mr. Chairman.

Senator **Kassebaum**. Thank you, Mr. Chairman.

I guess, Dr. Sanders, I would like to make a statement somewhat, too, because one of the things that has troubled me the most in the whole question of the student loan issue is that I feel that we are doing a real disservice to students to saddle them with these enormous debts.

It seems to me that we have got to do a better job of providing some career counseling and some guidance right at the beginning so that a student is going to understand that when the career they are going into, whether it is a 4-year education, or certainly I think the schools where they have had the highest default problems, proprietary schools, community colleges, the historically black colleges have had a high rate, that they should be given some advice as far as careers and proportionate salaries that would be commensurate with the loans that they are going to be saddled with.

It seems to me that we do a real disservice many times by encouraging them—they should be encouraged—but they should also know the responsibilities that lie ahead with that indebtedness. I feel strongly that this is a big responsibility that the schools have, as well. I know it is a question of personnel, many times, but it has become, it seems to me, sort of an accelerated process where it is just a given that a student will go, there will be a student loans, and many times I think it is only typical that a young person does not think that much further ahead about the field they are going into and what salaries may be available in that field that will enable them to help pay back the loans. I would just like to make that as a statement. And I do have another question.

Mr. **Sanders**. We do require, as I had mentioned in an earlier response, counseling of students about their obligations in assuming the loan. We are requiring now disclosure to that student of not only the completion rates but the placement rates, and also that counseling include information about projected income that the student might expect upon completion and placement.

Senator **Kassebaum**. But is that not only recently that that——

Mr. **Sanders**. Yes, ma'am. That is a part of the recent default initiative.

Senator **Kassebaum**. And my guess is that we have not had enough time to see the effects of that.

Mr. **Sanders**. That is correct. We have not seen the effects of that, yet.

Senator **Kassebaum**. I knew this was put in place just a year ago, was it not?

Mr. **Sanders**. Correct. That is correct, Senator.

Senator **Kassebaum**. I strongly support those initiatives.

Let me just ask a quick question, unless the answers have come back.

Mr. **Sanders**. Please.

Senator **Kassebaum**. I believe that HEAF, the Higher Education Assistance Foundation, that we are talking about right now elected to withdraw from several States a couple of years ago, and I think you mentioned yourself in commenting that they had decreased their volume, but this was in an effort to get their portfolio in better shape. And it is my understanding that at that time they asked the Department of Education about several other options, and the Department turned down those options.

I wonder if it would be useful, or if you even know what those options were and why those were rejected?

Mr. **Sanders**. Yes, Senator, your statement is correct. They did withdraw from a number of States. If a guarantee agency chooses to do business in a particular State by designation, then they must guarantee loans from all lenders.

Yes, they did ask to take other kinds of actions such as to select between and among lending institutions, which we would not under the law allow. There were other requests, too, and Larry, I would ask you to elaborate upon them.

TERMINATE THE PARTICIPATION OF SCHOOLS

Mr. **Oxendine**. One of the additional requests that was made of us was to permit them to terminate the participation of schools, especially proprietary schools, without cause. We indicated that they already have the authority by our regulation to terminate the participation of schools, but they would have to give the school a fair hearing and essentially go through the LS&T procedures.

It was responded that the LS&T procedures would take too long, and that would not give them the time they needed to turn the situation around.

In addition, they wanted to take the same action with respect to certain lenders who participated in the high volumes of proprietary school loans. We had the same response.

Senator **Kassebaum**. Let me ask, if they had been able to do that would that not have helped them at this juncture? If they had been able a couple of years ago to take those actions?

Mr. **Oxendine**. The proposals that they came to us with were in the same timeframe as when they withdrew from the 18 States, so this discussion took place over probably a 3-month period. So even those proposals that we rejected were not presented to us long before they withdrew from the 18 States. Had they withdrawn from the 18 States or taken some other drastic action to change the portfolio mix earlier, say a year earlier or 2 years earlier, yes, it is likely that that action would have been successful.

Senator **Kassebaum**. All right. I guess I misunderstood. The Department turned down though a request that they made to drop some lenders that were not performing, as well as some schools? Is that not correct?

Mr. **Oxendine**. They made the request to terminate participation of some lenders and some schools, but the request was not based upon any type of program violation. They wanted to simply terminate the participation of those entities because of the type of loans they were making. There were not other program violations. So we informed them that that would not be permissible; that to terminate the participation of a school or lender they would have to give those parties due process and go through the proper procedures.

Senator **Kassebaum**. If they had been able to do that, would they be faced with the situation they are today, in your judgment?

Mr. **Oxendine**. At the time that they—I think probably we would still have the same situation because of the timing of the request.

Had they made the request and had they been able to do that say a year earlier, it is likely that we would not have the situation we have today.

Senator KASSEBAUM. And in your judgment they knew a year earlier——

Mr. OXENDINE. No, I do not know that.

Senator KASSEBAUM. Thank you, Mr. Chairman.

The CHAIRMAN. Let us pin it down. I mean, why did they want to discontinue? They must have had reasons. What were their reasons?

REASONS FOR WANTING TO TERMINATE

Mr. OXENDINE. The reason that was given to us was the fact that these particular parties were participating very heavily in proprietary school loans, and the proprietary school loans generally default at a greater rate than other loans. And the Higher Education Assistance Foundation had a high proportion of proprietary school loans in its portfolio at that time, and they wanted to reduce the proportion of proprietary school loans. That was the action they proposed in order to affect that reduction.

The CHAIRMAN. But you decided not to concur in that action? Is that correct?

Mr. OXENDINE. That is correct.

The CHAIRMAN. Now some of these proprietary schools are essentially diploma mills, are they not?

Mr. OXENDINE. The ones in question, that was not my understanding.

The CHAIRMAN. You do not think that was the case?

Mr. OXENDINE. There was no discussion of the quality of instruction that was being provided.

The CHAIRMAN. Well did anybody ask?

Mr. OXENDINE. That was not an issue in the discussion, no.

Senator KASSEBAUM. Mr. Chairman, if I may just ask, this is really something that happened several years ago, so I am not sure that it is fair to be asking you this, but it is my understanding that HEAF asked the Department of Education if they could require cosigners on the student loans for some schools, and that was denied. They asked if they could quit guaranteeing loans for certain schools, and that was denied. They asked if they could stop guaranteeing loans for certain lenders, as we have gone through, and some that I know that were in difficulty, and Education again said, no.

HEAF then asked what action they could take to decrease their proportion of proprietary loans, and the Department of Education suggested pulling out of some States. They took this suggestion and withdrew from 18 States about 2 years ago.

Now is that approximately correct?

Mr. OXENDINE. Yes, it is. I would like to elaborate on the cosigner proposal, however. Our response to HEAF concerning the cosigner proposal, first of all they wanted to require cosigners only of certain students, not based on creditworthiness but based on the type of school the student was attending. We informed HEAF that in our opinion that was in violation of the Equal Credit Opportunity Act.

The **Chairman**. Well, let me go back to Senator Dodd, and then there are some things I want to get into.

Senator Dodd.

Senator **Dodd**. I wanted to make sure, Mr. Chairman, that the information we have requested, the LS&T procedures, the number of program reviews, and the salary and expenses budget request—I must say that I am very surprised these numbers were not here. These questions I presume you would have presumed that someone up here would be asked. They are not off-the-wall questions.

Do you have some answers on those?

Mr. **Sanders**. The information is now here, Senator.

If I may, Mr. Chairman, for three separate years, 1987, 1988, and 1989, we have initiated, in 1987, first of all, some 14 terminations. In 1988, 27. And in 1989, 30.

Completions out of those that were initiated: In 1988, we completed terminations in 10 actions; and in 1989, 16 actions. The experience has been that once we start that procedure, Mr. Chairman, Senator Dodd, before the termination is completed, schools tend to close their doors.

Senator **Dodd**. This is out of the 8,000 institutions that are under the program?

Mr. **Sanders**. That is correct, Mr. Chairman, Senator Dodd.

With respect to actions that were taken by guarantee agencies and then disqualifications taken, in 1988 there were two; in 1989, there were six; and in 1990 to this point, there have been three.

The **Chairman**. I am sorry, could I ask you to repeat the definition of that category again?

Mr. **Sanders**. Yes. In this particular case, the guarantee agency takes an action which we then apply nationwide. In 1988, there were two such actions taken. In 1989, there were six. In 1990, to this point, there have been three.

I might also mention that from the start of 1990 in the LS&T actions, we have initiated 12 to this point.

Senator **Dodd**. Now there are some 47 guarantee agencies. Is that correct?

Mr. **Oxendine**. That is.

Senator **Dodd**. Forty-seven agencies that, as it works, I mean correct me if I am wrong, but my understanding is that when the default occurs the bank goes to the guarantee agency that pays 100 percent on the default. Is that right?

Mr. **Sanders**. That is correct.

Senator **Dodd**. Then the guarantee agency goes to the Department of Education. And if the number is in excess of 9 percent, then the Department pays 80 percent.

Mr. **Sanders**. That is correct.

Senator **Dodd**. So we have the situation where the guarantee agencies are running in arrears on these matters.

Now you have, of the ten that were completed in 1988, two. What is the matter with the other eight?

Mr. **Sanders**. In the case of the 10 terminations completed, in the remainder, the schools may have closed before the action was completed, Mr. Chairman, Senator Dodd.

Senator **Dodd**. That deals with the 17, you mean? I am assuming in 17 the schools closed? There were 27——

Mr. **Sanders**. 27 were initiated and 10 were completed. The difference would be 17.

Senator **Dodd**. So there were 10 that were completed, but only in two has there been guarantee action?

Mr. **Sanders**. No. Two separate actions are taking place here. One is the termination action taken by Education. The others are actions that are taken by the guarantee agencies.

Senator **Dodd**. OK.

Mr. **Sanders**. There are two different actions taking place. When the guarantee agency takes such an action, we acknowledge and respect that and apply it nationwide.

Senator **Dodd**. All right. We are dealing with 8,000 institutions, and the magnitude of the potential problem does not leap off the page at me. What do you read into these numbers? My reaction is that you are not aggressively going after enough institutions here, given the size of the problem, but I may be wrong in that. What is your reaction?

Mr. **Sanders**. Well, one, I think we have to look at a multifaceted approach to dealing with the problem, one of which is the termination action; the other, to strengthen what is required of the accrediting authorities; strengthening what is required of State licensing authorities.

Senator **Dodd**. But am I to draw the conclusion from this that 7,950 institutions across this country are doing a good job?

Mr. **Sanders**. I do not think I would encourage you to draw that conclusion, Senator Dodd. [Laughter.]

Senator **Dodd**. Well, the point is that you have got tools available to you now.

The **Chairman**. Well, if you would yield, part of the question is do you have enough tools? Do you need more people? Do you feel that you are staffed up to a level where you can really do the job the way you want to do it? I do not mean to preempt the question, but——

Senator **Dodd**. No; well that was my other question, salaries and budget stuff.

The **Chairman**. Do you feel you have what you need to really do this job the way you would like to do it?

ADDITIONAL STAFF

Mr. **Sanders**. We have been asking for and receiving additional staff to deploy in this particular area, Mr. Chairman. We have recognized, as I mentioned before, the relationship between the program monitoring that we are able to do and the size of our S&E budgets. We have been asking for additional and have placed additional staff into these efforts.

I do believe that there will be a number of actions that we will require as a result of this experience, and that we will be back to you asking for other kinds of authorities and perhaps including additional staff to perform the monitoring and perhaps the auditing function.

Senator **Dodd**. How about the program reviews in the last 2 years? Do you have a number on that?

Mr. **Sanders**. Larry?

Mr. **Oxendine**. I can give you an estimate. For the last year it was approximately 1,500 program reviews of schools, and approximately 1,600 will be done this year.

Senator **Dodd**. So that would sort of roughly correspond. As was pointed out, in 1981 there were 1,900; 890 in 1986; you are getting closer to that 1981 number.

Mr. **Oxendine**. Yes, sir. I would like to point out that the Congress did in fact authorize additional staff for the Department of Education approximately 2 years ago. We now have that staff up to speed and the program reviews are substantially increasing in numbers.

We were authorized, I believe it was, 90 additional staff, and also the salaries and expense moneys to support that staff.

Senator **Dodd**. By the way, Mr. Chairman, I should have pointed out earlier when I asked the question about the legislation that passed the Senate, some of which was under the leadership of the chairman here, that the House did not act on those bills. To the credit of the Bush administration, they took a lot of what was in the Senate-passed legislation and converted it into regulation, so that even though we did not get legislative action in the other body, the administration saw the merit of what was being proposed and in fact actually coauthored a lot of the stuff and took I think the positive steps of moving forward to see to it that some of those ideas were actually converted into regulatory schemes which are helping in this area.

So I should have made that point when I asked the question about the legislation.

Mr. **Sanders**. I appreciate that, Senator.

Senator **Dodd**. At any rate, under the present rate you have pointed to your increased personnel costs—you are trying to get those up, and I appreciate the kind of burdens you are operating under. But if you maintain a rate of around 1,600, what you will be looking at then is program reviews of each institution about once every 5 or 6 years. Is that a desirable goal?

What would you consider it to be, realistically? I presume you might tell me 8,000 schools each year you would like to look at, but realistically what should you be looking at each year?

Mr. **Sanders**. We do not necessarily have to look at every school every year——

Senator **Dodd**. No. I agree with that. But what is the number?

Mr. **Sanders**. Larry, do you want to respond?

Mr. **Oxendine**. I am not sure that there is any particular number, and let me elaborate on that if I may. The institutions that should be looked at are generally not the State institutions——

Senator **Dodd**. Are definitely?

Mr. **Oxendine**. Are generally not the State institutions, the Harvards, et cetera, the Ohio States. They generally——

Senator **Dodd**. The University of Connecticut.

Mr. **Oxendine**. The University of Connecticut, definitely. [Laughter.]

Senator DODD. Obviously this guy is going to run for public office. [Laughter.]

Mr. OXENDINE. I'm sorry. They provide the resources needed to administer the program properly.

The CHAIRMAN. Michigan is a fine institution. [Laughter.]

Mr. OXENDINE. So I believe that once every several years, and possibly 5 years is fine for those type of institutions. There are other types of institutions, however, that we should target our program review activities on.

I would also like to mention that, by regulation, guarantee agencies are also required to conduct program reviews of institutions, and they have to conduct program reviews of the largest institutions within their States, the 10 largest I believe it is, in addition to program reviews of any school with a default rate above 40 percent. So there we are targeting on large schools and also risky schools.

Senator DODD. That makes sense.

Mr. OXENDINE. So that is supporting the Federal activity.

Senator DODD. But again—and I appreciate that distinction; I think it is a very important one to make—but again, I do not want to be simplistic here, but as an overall gross number? What do you believe, in order to do the kind of proper supervision, what sort of numbers are we looking at here, based on the gross numbers we are dealing with? And I think the distinction is an important one.

Mr. OXENDINE. I personally believe that if we can get in the range of 1,500 to 2,000, that is sufficient, because then you are doing program reviews of the riskiest schools more often, and the program reviews of the less risky schools less often.

Senator DODD. OK. Thank you, Mr. Chairman.

The CHAIRMAN. Let me just ask this, before going to Senator Pressler. If I understand the testimony properly there are 47 guarantor organizations out there. Am I right on that?

Mr. SANDERS. Guarantee agencies.

Mr. OXENDINE. I would like to clarify the 47. The number changes, depending on how you count them. HEAF is considered to be six guarantee agencies. Sometimes also people consider them to be one. So in the 47, HEAF is considered to be one.

The CHAIRMAN. Now the people that run these—let us say the chief executive officer of one of these agencies—what do they earn a year?

Mr. OXENDINE. I have no idea.

Mr. SANDERS. We have no idea of the answer to that question, Mr. Chairman—at least I do not.

The CHAIRMAN. Do you think any of them earn as much or more than the President of the United States?

Mr. SANDERS. I have no way of knowing, Mr. Chairman.

The CHAIRMAN. Do we have no control over the administrative cost side of what goes on there?

Mr. SANDERS. No, we do not, Mr. Chairman.

The CHAIRMAN. Should we have?

Mr. SANDERS. We mentioned earlier that there may be some authority that is lacking that would be helpful. I do not know that. That is certainly worth considering, but I would not want to respond affirmatively or negatively today.

The **Chairman**. So you have no way of knowing whether the guarantor agencies that are successful, are ones that make money, pay high salaries? You have just no hunch whatsoever, eh?

Mr. **Sanders**. We have no knowledge about that relationship.

Senator **Dodd**. But then they come to you and they ask you to reimburse them at 80 percent of their losses, if their losses exceed 90 percent, and yet—is there no examination of that, of what goes on in those guarantor agencies?

Mr. **Sanders**. Oh, we have an examination of what goes on in those guarantee agencies, but it does not extend to oversight responsibility for what they pay their chief executives.

Senator **Dodd**. I get a sense you would like that, though.

Mr. **Sanders**. I do not know that single thing is going to solve our problem, Mr. Chairman and Senator.

Senator **Dodd**. No, but we would like to know a bit more about them is my sense.

Mr. **Sanders**. Obviously we would like to know more about the operations of those agencies.

The **Chairman**. There is a reason for this line of questioning. We have gone through a decade of privatization, and we keep peeling things off, and we keep setting up private-sector intermediaries and organizations, and yet we end up leaving the Government and the taxpayer as the payee of last resort to pick up the tab for what does not work right. And I have a hunch—and it is only a hunch, and so that is why I am asking the questions—that in some of these areas, and this may or may not be one, that the people who get into the act to do this make a lot of money at it; and that there are very handsome salaries involved.

As I say, I cannot say that that is the truth here, and it may not be, and if so I want it on the record one way or the other.

I am astonished at how many people manage to get into the pipeline on these kinds of things.

We saw in some investigative activities that we have been doing here on HUD that some people end up making multiples of what we pay the President of the United States as an annual salary. I use that as a sort of benchmark in my mind. You can use professional basketball stars, or baseball stars, but the numbers are so astronomical that they lose meaning.

But I think a good benchmark is what we pay the President of the United States who has got clearly the most important job in the country, if not in the world. Whenever I see somebody that is out there doing a piece of public service work and is ending up getting paid more than the President of the United States, I immediately become concerned about that and wonder if something is not operating the way it should.

But you have no way of knowing whether there is that kind of money out there in terms of the people who are handling these chores or not?

Mr. **Sanders**. No, I do not.

Senator **Dodd**. But—excuse me, Mr. Chairman—but you have the authority to get that information?

Mr. **Sanders**. No, I do not.

The **Chairman**. He is saying he does not have the authority.

Senator **Dodd**. You have no authority to get that information?

Mr. SANDERS. No, I do not.

The CHAIRMAN. See, I think you have got to be able to monitor the overhead in order to decide what is an appropriate share of the losses to eat at the other end. I do not think the Government can hand a bill to the taxpayers of the country when there have been transactions behind it that may be out of line that have helped produce the loss.

I mean, it is like we are not connecting all of the connecting links properly. Do you share that concern?

Mr. SANDERS. Well right now the way the law connects those and sets the percentage rate for reinsurance from the Federal Government is dependent upon the default experience of the guarantee agency's portfolio; no other factor.

The CHAIRMAN. Well, but that does not leave you limp in terms of being able to take a look at it and say, as an administrator in this area I do not like that.

Have you brought forward a proposal within the administration that has been stymied? Or are you in the midst of drafting one? Or do you have anything in mind that you think we ought to do in this area?

PROPOSALS ON DEFAULTS

Mr. SANDERS. Mr. Chairman, we brought forward proposals to deal with the default issue. None of those include exercising that kind of oversight.

The CHAIRMAN. What do you think of the idea?

Mr. SANDERS. I think it merits looking at in terms of generally understanding, if it is specific to what the salary of the CEO is, but——

The CHAIRMAN. No, no, that is only an illustration.

Mr. SANDERS [continuing]. Generally to the management capability of the agency, I think that is worth considering.

The CHAIRMAN. In 2 years we have had the losses go up $1 billion. I do not know if it is kids that are getting good educations that cannot go out and find jobs because there is a slack economy. I would not think so. The unemployment rate is really quite low. Or whether it is the diploma mills that are churning out so-called "education" experience that is worthless, and you end up having a situation where the student cannot go out and get a job, and cannot repay the loan. Or students who basically say I am not going to repay it.

But when you have got $1 billion increase, I think you have got to go back through the pipeline. You have got to really put a very tight measure around everybody that is in the chain. It sounds like to me that the way the system is geared now, that does not happen automatically.

It sounds to me like something needs to be redesigned here. That is part of what I am gathering as I listen to these answers.

Mr. SANDERS. Yes, and I would agree with you that that extends beyond just what we do as an oversight of guarantee agencies. It means extending our work with other institutions that provide education and training.

I would also though point out, Mr. Chairman, that the increase in the default rate is also in part due to the significant increase in the volume of loans that has taken place, as Senator Dodd pointed out, too. There has been a tremendous increase in the numbers of students, and therefore the volume of the loans, and there is a relationship there.

Senator DODD. That was a policy change, too.

Mr. SANDERS. Correct.

The CHAIRMAN. Let me to go Senator Pressler——

Senator DODD. Could I just ——

Senator PRESSLER. Thank you——

Senator DODD [continuing]. If Senator Pressler would not mind, just because I am going to have to go, I just want to ask one——

Senator PRESSLER. I am going to have to leave in about 2 or 3 minutes.

Senator DODD [continuing]. Quick question to follow up on this thing. I will be very fast, then.

Senator PRESSLER. OK.

Senator DODD. I just want to ask about HEAF and whether or not in your view there is any public interest in keeping HEAF from going bankrupt. It seems like an obvious question, but I think it is important to raise. And what are the Department's thoughts on the advantages or disadvantages of preventing HEAF from going bankrupt?

Mr. SANDERS. Currently HEAF has a $9.6 billion loan portfolio that it has guaranteed. It additionally has a little over $2 billion of loans that are in default that it is servicing. If HEAF goes bankrupt, if we are not able to place some other entity or entities in the place of the guarantor to service that portfolio, then there could be significant losses that I am not able to estimate today to the Government. But that portfolio could lose its integrity, and we could face serious problems.

So, yes, I do believe it is the interest of the Federal Government to see an entity or entities in place to perform the functions that are currently being performed by HEAF.

Senator DODD. Do you have any idea of the total dollar amount of what we are talking about here?

Mr. SANDERS. If they were to go bankrupt?

Senator DODD. Yes.

Mr. SANDERS. No, I do not know today. I do have some idea that I mentioned in earlier testimony about the outside potential cost of options that we are looking at in terms of putting another entity or entities in place to perform those functions so that that portfolio is secure and those loans are indeed guaranteed, and that relationship between student, lender, guarantee agency, and the Federal Government is maintained.

The CHAIRMAN. I think I have got to go to Senator Pressler.

Senator DODD. I appreciate that. I apologize and I thank Senator Pressler for that, as well.

Senator PRESSLER. It is my understanding that HEAF stopped charging a standard 3 percent insurance origination fee in an effort to attract more 4-year college type loans into their portfolio. In turn, guarantee agencies across the Nation have ceased charging the fees in an effort to be competitive. But this resulted in an obvious decrease in revenue coming into HEAF.

Is this information correct? And do you think this was a wise course of action for HEAF to take?

Mr. **Sanders**. That information is correct, Mr. Chairman, Senator. It is easy to second-guess earlier decisions. Obviously had they not made that decision, their cash position today would have been different.

Senator **Pressler**. Now, Mr. Chairman, I have an opening statement to place in the record.

The **Chairman**. Without objection, so ordered.

Senator **Pressler**. I will just read part of it.

I have been a strong supporter of the Guaranteed Student Loan Program. More than 80 percent of South Dakota college and vocational-technical students depend on financial aid to continue their education. I would recommend that, as we consider this matter, we keep in mind the students. There are certainly risks to banks, the Federal Government, and other entities. But ultimately the students would suffer the most if anything happened to curtail the guaranteed student loan program.

The financial collapse of the Nation's largest student loan guarantee agency, the Higher Education Assistance Foundation, has serious, serious consequences.

[The complete prepared statement of Senator Pressler follows:]

STATEMENT OF SENATOR LARRY PRESSLER

Mr. Chairman, I commend you for calling this hearing on this critically important issue. It is very appropriate that the Banking Committee is examining these recent developments.

I am a strong supporter of the Guaranteed Student Loan Programs. More than 80 percent of South Dakota college and vocational-technical school students depend on financial aid to continue their education. I would recommend that as we consider this matter we keep in mind the students. There are certainly risks to banks, the Federal Government and other entities. But ultimately the students would suffer the most if anything happened to curtail the guaranteed student loan program.

The financial collapse of the nation's largest student loan guarantee agency, the Higher Education Assistance Foundation [HEAF], has serious consequences. Therefore I think it is timely for us to start examining the causes, effects and possible solutions right now. I look forward to hearing the testimony of our expert witnesses today.

Mr. Chairman, I might also say that I hope we will be receiving testimony from HEAF officials today. Maybe this has been covered earlier in the hearing today, but are we going to hear from them?

The **Chairman**. Well, we may very well do that, Senator Pressler. We are sensitive to the notion that the Department is engaged in some sensitive negotiations right now, and we want those to be able to go forward without any interference or problem that might arise. I think today we are trying to stay with a certain scope of examination so that the Department has some room to try to solve this problem.

But we do not want to foreclose the possibility of a broader scope at some appropriate point, and I will be mindful of your thoughts on it.

Senator **Pressler**. Good. I have one or two questions for the record.

The farm bill is on the Senate floor today, and I am living over there for the time being. I do have a question later for the president of Sallie Mae. I read in their statement that Sallie Mae enjoys a triple-A credit rating from the rating agencies. To which agencies does that refer? And what effect do you believe acquiring the HEAF portfolio, as you propose, would have on those ratings?

That is a question I would like to leave for the president of Sallie Mae. I know you folks cannot address that question.

Mr. Chairman, I have one or two questions for the record that I would like to submit.

The CHAIRMAN. Very good, Senator Pressler, and we will have those answered for the record.

I want to just cover one more item, and then we will go to our final two witnesses. As I understood the answer a moment ago in regard to the HEAF portfolio, there is something on the order of $7 billion——

Mr. SANDERS. $9.6 billion in loans outstanding that are guaranteed.

The CHAIRMAN. Let me get the numbers straight. $9.6 billion outstanding——

Mr. SANDERS. That is correct.

The CHAIRMAN [continuing]. And the amount in default?

Mr. SANDERS. They have an additional $2 billion of loans that are in default that they are servicing and seeking to collect.

The CHAIRMAN. $2 billion.

Mr. SANDERS. Mr. Chairman, those numbers are as of September 30, 1989.

The CHAIRMAN. September 30, 1989.

Mr. SANDERS. Yes.

The CHAIRMAN. Is there a reason why those numbers are so out of date?

Mr. OXENDINE. That was the last annual report we received from HEAF. We are updating those numbers.

Mr. SANDERS. We are currently updating those numbers, but that is from the last annual report that we have from them. We will——

The CHAIRMAN. I assume you have asked them what they think it is. What kind of an answer are you getting that would be more timely than September 30, 1989?

Mr. SANDERS. Do you have a more recent answer?

Mr. OXENDINE. My staff very shortly will have the numbers as of June 30.

The CHAIRMAN. They are returning phone calls, I assume?

Mr. OXENDINE. Yes, definitely.

Mr. SANDERS. Yes.

The CHAIRMAN. When you say "very shortly," do you mean shortly today, or tomorrow, or when?

Mr. OXENDINE. I would hope this afternoon.

The CHAIRMAN. You will know this afternoon?

Mr. OXENDINE. I would hope I would know this afternoon.

The CHAIRMAN. Any idea? Is there any range that you anticipate here? Does this $2 billion default number look like it is going to jump up?

Mr. SANDERS. It will——

Mr. **Oxendine**. I—I am sorry, Mr. Under Secretary.

Mr. **Sanders**. We know that it will go up at least by $300 million additional, Mr. Chairman. That is HEAF's approximation of the value of loans that it is currently holding for which it has paid the lenders 100 percent and that it will be submitting to us for reinsurance claims. So it will at least go up by that $300 million.

The **Chairman**. So it looks like it is going to be at least $2.3 billion that will be in default? Is that correct?

Mr. **Sanders**. That is correct.

The **Chairman**. Now without getting into the specifics of your negotiations, if you are going to convince somebody else to come in and take this over, and if these are in default and are uncollectible, are you not probably going to have to do that on a basis that at some time those losses will have to come on through to the Government and be paid by the Government?

Mr. **Sanders**. Well those, Mr. Chairman, the $2 billion has already been—the reinsurance claims have already been paid. HEAF then can work those loans to get them into repayment. Under the law, they then receive 30 percent, sending the Government 70 percent of what they collect.

Many of those loans will be worked, and they will be collected——

The **Chairman**. I see.

Mr. **Sanders** [continuing]. And will benefit both the Government and HEAF or its successor organization.

The **Chairman**. Is this then what gives you that net figure that I recall you giving earlier, $100 million? Am I recalling that number in a context that is not appropriate to this subject?

Mr. **Sanders**. I was looking at a general number that would be the outside cost associated with putting a successor agency or agencies in place to pick up and perform the functions of HEAF.

With respect to the loans that are already in default, working those loans successfully is of direct benefit to the guarantee agency because it is able to therefore keep as an asset the difference between the amount collected and the 30 percent and whatever it costs the agency to actually work and get the loan back into repayment. So that would not be a cost to them at all, but rather it would be a benefit.

OVERHEAD COSTS OF INTERMEDIARY

The **Chairman**. I understand. Well, I am interested in the overhead costs of this intermediary function that is carried out for us. They may be entirely appropriate and in line with what common sense would say, and I am all for doing things by using a private-sector capacity as long as we are not being bled in the name of privatization. I would be very interested—again I am going to use sort of the benchmark of what we pay the President of the United States—to find out what we are paying people out there, and I would like you to ask.

So I am asking for the answer from you. If anybody asks why you are asking, then you can say you are asking because you were asked by the Banking Committee for the answers, and I would like you to get the answers and send them to us. If you find that you cannot get them, then let me know that, as well.

I appreciate the testimony you have all given. There will be additional questions for the record for you.

Let me excuse you at this time and call our next witnesses to the table.

Mr. SANDERS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Sanders. We will just pause for a minute while our first witnesses and others have a chance to exit the room and we get the room quiet so that we can hear from Mr. Franklin Frazier who is the Director of Education and Employment Issues of the Human Resources Division of the U.S. General Accounting Office. He is accompanied by Mr. Eglin and Mr. Chrissman. We are pleased to have the three of you here.

Mr. Frazier, we will make your full statement a part of the record, and we would like to invite you now to give us your summary comments.

STATEMENT OF FRANKLIN FRAZIER, DIRECTOR, EDUCATION AND EMPLOYMENT ISSUES, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, ACCOMPANIED BY JOSEPH J. EGLIN, ASSISTANT DIRECTOR, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE; AND CHRISTOPHER C. CHRISSMAN, SENIOR EVALUATOR, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. FRAZIER. Thank you, Mr. Chairman.

We are pleased to be here today to discuss the Stafford Student Loan Program. We believe this program is of extreme importance to students seeking postsecondary education and to the future work force of our country. However, in recent years the student loan program has received much criticism mainly due to its high default rate.

You asked us for our comments on three topics:

One, how the Stafford Student Loan Program works;

Two, the growth in the loans guaranteed and defaulted; and

Three, the concerns surrounding the financial problems of HEAF.

The Stafford Student Loan Programs makes three kinds of loans: Stafford loans, supplemental loans for students, and parent loans for undergraduate students. Stafford loans are low-interest loans, currently 8 percent loans, that are made on the basis of financial need. The Stafford Loan Program can provide assistance up to about $17,000 for undergraduate students. The Federal Government pays the interest on the loans while the students are in school, and the students generally begin repayments within 6 months after leaving school.

The supplemental and parent loans are not awarded on the basis of financial need. Interest rates vary annually, currently running about 12 percent. Both the parent loan and the supplemental loan provide assistance up to $20,000, and repayment starts 60 days after the loan is made.

In 1989 the Stafford program made over 4 million loans in the amount of about $12 billion. The program accounts for about 61 percent of student aid provided by the Department of Education. Both public and private post-secondary schools participate in the program.

Each loan is insured by one of 47 guaranty agencies. The guaranty agencies have a primary role in administering the program. Guaranty agencies can collect an insurance premium of up to 3 percent for each loan made. They also annually receive a 1 percent administrative cost allowance on loans they guarantee each year. They serve as a lender of last resort for students who have trouble obtaining loans from normal institutions, and they reimburse lenders for 100 percent of defaulted claims if the loans were properly serviced.

The Department of Education oversees the program, and reinsures the guarantee agencies for 100 percent of defaulted loans, except in those cases where the agency has high default rates. Education also makes interest payments to lenders for Stafford loans borrowed while students are in school.

Between 1983 and 1989, program loans have grown from about $7 billion to over $12 billion annually. This represents about an 83 percent increase in student loans. Similarly, the number of loans increased by 56 percent from $3 million to $4.7 million.

During the same period, defaults increased over 352 percent, from $444 million to about $2 billion. In terms of program costs, defaults increased from 10 percent in 1983 to about 36 percent in 1989.

Studies show that the default rate differs for different kinds of schools. For example, the default rate for 4-year institutions is about 10 percent; for 2-year institutions it runs about 20 percent; and for proprietary or trade schools, it runs around 35 percent.

Under normal circumstances, lenders that properly originate their loans are guaranteed 100 percent reimbursement for a defaulted student loan by one of the 47 guaranty agencies. The Department reinsures the guaranty agency for 80 to 100 percent of the loans, depending on the agency's default rate.

When a guaranty agency such as HEAF encounters financial difficulties. it is not clear who if anyone, is responsible for honoring the guarantee to the lender. The Department has the authority to guarantee loans held by lenders. However, it does not have an obligation to do so.

Mr. Chairman, this concludes my summary. We will be happy to respond to your questions.

[The complete prepared statement of Franklin Frazier follows:]

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
2:00 p.m. EDT
Friday
July 27, 1990

Financial Problems in the Stafford Student Loan Program

Statement of
Franklin Frazier, Director
Education and Employment Issues
Human Resources Division

Before the
Committee on Banking, Housing and Urban Affairs
United States Senate

SUMMARY OF GAO TESTIMONY ON THE FINANCIAL PROBLEMS IN THE STAFFORD STUDENT LOAN PROGRAM

The Stafford Student Loan Program (formerly called the Guaranteed Student Loan Program) makes three kinds of student loans: Stafford Loans, Supplemental Loans for Students (SLS), and Parent Loans for Undergraduate Students (PLUS). Stafford loans are low interest (currently 8 percent) loans made on the basis of financial need; the federal government pays interest on the loan while students are in school; and students generally begin repayment within 6 months after leaving school. SLS and PLUS loans are not based on financial need; interest rates vary annually (currently 11.49 percent); both can provide assistance up to $20,000; and repayment generally begins 60 days after the loan is made.

In 1989, the Stafford Student Loan Program made over 4 million loans in the amount about $12 billion. The program accounts for about 61 percent of student aid provided by the Department of Education. Both public and private postsecondary schools participate in the program. Each loan is insured by one of the 47 state or nonprofit guaranty agencies which administer the program and report to the Department of Education. Guaranty agencies can collect an insurance premium of up to 3 percent for each loan; they serve as lenders of last resort for students unable to obtain loans through other lenders; and they reimburse lenders for 100 percent of defaulted claims if the loans were properly serviced. The Department of Education oversees the program; reinsures the guaranty agencies for 100 percent of defaulted loans, except in those cases where the agencies have high default rates; and makes interest payments to lenders for Stafford loan borrowers while they are in school.

GROWTH IN LOANS, DEFAULTS, AND PROGRAM COSTS

Between 1983 and 1989, loans grew from about $7 billion to over $12 billion annually--an 83 percent increase. Similarly, the number of loans increased 56 percent from 3 million to 4.7 million. During the same period, defaults increased 352 percent from $444 million to $2 billion. In terms of program costs, defaults increased from 10 percent in 1983 to about 36 percent in 1989.

FINANCIAL RISKS ASSOCIATED WITH STUDENT LOANS

Under normal circumstances lenders that properly originate and service student loans are guaranteed 100 percent reimbursement by one of the 47 guaranty agencies. The Department reinsures the guaranty agencies for 80 percent to 100 percent of loans depending upon their default rates. In the case that a guaranty agency encounters financial difficulty, such as HEAF, who would honor the guarantee for the lender becomes unclear. The Department has authority which it can use to guarantee loans held by lenders; however, they do not have an obligation to do so.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Stafford Student Loan Program. This program is of extreme importance to students seeking a postsecondary education and to the future work force of our nation. However, in recent years it has been the subject of greater scrutiny and much of that has focused on those student-borrowers who have defaulted on their loans, and the resulting financial liability to the federal government.

I will focus my comments today on (1) how the Stafford program works, (2) the growth in loans guaranteed and defaulted, and (3) the concerns surrounding the financial problems being experienced by the Higher Education Assistance Foundation (HEAF).

MAJOR FINANCIAL AID PROGRAMS

The Department of Education offers seven major student financial aid programs. These programs were established by title IV of the Higher Education Act, as amended, and include Pell grants, Supplemental Educational Opportunity Grants, College Work Study, Perkins loans, Stafford loans, Parent Loans for Undergraduate Students (PLUS), and Supplemental Loans for Students (SLS). For fiscal year 1990, the Department estimates that the seven programs will make almost $18 billion of student aid available through over 9.7 million awards. (See table 1.)

Table 1: Estimated Aid Available and Number of Awards for the Seven Major Financial Aid Programs (Fiscal Year 1990)

Aid program	Aid available (in millions)	Number of awards (in thousands)
Pell grants	$4,763.0	3,214
Supplemental grants	487.9	678
Work study	823.3	876
Perkins loans	860 0	804
Stafford loans	8,769.0	3,331
PLUS	827.0	258
SLS	1,368.0	545
Totals	$17,898.2	9,706

The Stafford Student Loan Program, formerly called the Guaranteed Student Loan Program, consists of Stafford, PLUS, and SLS loans. These three kinds of loans will represent 61 percent of federal student aid made available in fiscal year 1990. These loans are guaranteed by the federal government against borrowers' death, disability, bankruptcy, and reinsured to the guaranty agency against default. Banks, credit unions, and savings and loan associations are the primary providers of student loans.

The three types of loans differ somewhat in their terms and conditions and I would like to highlight some of these differences.

Stafford Loans

Stafford loans--formerly called guaranteed student loans--are the largest of the three loan types (80 percent of loans guaranteed in 1990) and have been available since the program was created as part of the Higher Education Act of 1965. The loans are based on the student-borrower's financial needs, however, borrowers do not have to demonstrate their credit worthiness. Other key facts are:

--Interest rates for new borrowers are 8 percent for the first 4 years of repayment and 10 percent after that.

--Maximum loan limits are $17,250 for undergraduates and $54,750 for graduate students.

--Borrowers generally have a 6-month grace period after leaving school before repayment begins.

PLUS Loans

These loans enable parents to borrow funds for each dependent student (those who are not generally responsible for their own financial support) enrolled at a school. These loans basically started in 1981 and are not needs-based. Other key facts are:

--Interest rates are variable and are determined once a year with a ceiling of 11.49 percent, which is the current rate.

--Maximum loan limits for each dependent are $4,000 per year to a total of $20,000.

--There is normally no grace period and payment of principal and interest must generally begin within 60 days after the loan is made.

SLS Loans

These loans are available to independent undergraduates (those students generally responsible for their own financial support) and graduate students. These loans basically started in 1982[1] and like PLUS loans are not needs-based. Also like PLUS loans, SLS loans generally have the same interest rate, borrowing limits, and no grace period. However, legislation passed in December 1989 restricted the availability of SLS loans for such factors as the school's borrower default rate and the lack of a high school diploma or a general equivalency degree.

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[1] SLS were part of the Auxiliary Loans to Assist Students program prior to 1986 and their terms and conditions are similar, and both are reported by the Department as SLS loans.

HOW THE STAFFORD STUDENT LOAN PROGRAM OPERATES

The program involves five parties: students, schools, lenders, guaranty agencies, and the Department of Education. I would like to provide some information on each party, using Stafford loans as a case example. (We have attached a chart that displays the life cycle of a Stafford loan.)

The Student

The student initiates the loan process. The student provides eligibility information to the school, applies to a lender for the loan after the school approves eligibility, arranges for repayment with the lender, and repays the loan. Stafford loan borrowers receive a federal subsidy throughout the period of their loans, including a below market interest rate, and make no payments on the loan while they attend school. The student repays the loan after completing or otherwise leaving school. Between fiscal year 1983 and 1989, the number of Stafford loans guaranteed each year will have increased from about 3 million to almost 4.7 million.

The School

The schools verify students' eligibility and the amount of financial aid needed. There are about 8,000 schools participating in the Stafford program. The kinds of schools participating in the program are categorized by: 2-year public, 2-year private, 4-year public, 4-year private, and proprietary (for profit trade and vocational) schools.

The Lender

Lenders make loans under the programs' guaranty provisions, and must exercise proper care in making, servicing, and collecting them. Lenders bill the Department each quarter for the federal interest subsidy payment for the loans they hold. These payments include (1) the students' interest while they are in school, and (2) during the life of the loan, an interest subsidy that is intended to provide lenders with a near-market rate of return. If borrowers fail to repay loans, lenders file default claims with the guaranty agency, but cannot be reimbursed for their claims until borrowers have been at least 180 days delinquent. They also receive 100 percent reimbursement if they have follow required procedures.

There are over 12,000 lenders participating in the program. As of September 30, 1989, they held about $50 billion in outstanding loans. Most of the loans are held by a small number of lenders. For example, 25 lenders had 54 percent of the $50 billion outstanding, and one organization--the federally chartered Student Loan Marketing Association--had 27 percent ($13.5 billion) of the total. (See table 2.)

Table 2: Ten Largest Holders in the Stafford Loan Program (as of September 30, 1989)
(Dollars in millions)

Loan holder	Amount outstanding
Student Loan Marketing Association	$13,483.3
Citibank (New York)	2,104.2
California Student Loan Finance Corp.	1,147.0
Nebraska Higher Education Loan Program	1,057.8
Chase Manhattan Bank (New York)	954.7
Chemical Bank (New York)	858.4
New England Education Loan Mktg. Corp	776.2
Penn. Higher Education Assistance Agency	521.3
Marine Midland Bank (New York)	503.1
Manufacturers Hanover Trust Company	456.3

The ultimate risk to lenders today is $50 billion plus accrued interest, assuming that the $50 billion in outstanding Stafford loans at the end of fiscal year 1989 was not guaranteed because all guaranty agencies were insolvent, and the government failed to provide a guarantee. This maximum liability also assumes that no part of the $50 billion in loans were repaid. From a practical point, however, the Department said that borrowers repay approximately 89 percent of the amounts due.

The Guaranty Agency

The guaranty agencies carry out several tasks, including: (1) issuing guarantees on qualifying loans, and when borrowers fail to repay their loans due to death, disability, bankruptcy, or default, reimbursing lenders for their claims; (2) charging students an insurance premium of up to 3 percent of the loan; (3) verifying that lenders properly service and attempt to collect loans before the agency pays default claims; (4) collecting the annual 1 percent administrative cost allowance for the Department; and (5) collecting on loans they retained after paying lenders claims, remitting to the Department its portion of monies the agency subsequently collect from defaulted borrowers.

If lenders choose not to make loans to eligible students--for example, those attending schools with high default rates--the guaranty agency must find another lender or become the "lender of last resort" itself. There are 47 guaranty agencies--state agencies or private nonprofit organizations--that report to the Department of Education on their administration of the program in the 50 states, District of Columbia, the Pacific Islands, Puerto Rico, and the Virgin Islands.

The risks to the guaranty agencies relate mostly to the difference between what it receives in reinsurance from the Department, and what it pays to lenders for their default claims. The reinsurance rate (100/90/80 percent) to guarantors depends on the agencies reaching a certain default rate threshold during each fiscal year. For example, if a guaranty agency's defaults in a fiscal year reach 5 percent of loans in repayment at the end of the previous fiscal year, its reinsurance rate would be 90 percent for the remainder of the fiscal year; if its defaults reach 9 percent of loans in repayment, the reinsurance rate decreases to 80 percent. The lower reinsurance rate remains in effect for the remainder of the fiscal year. With the start of the new fiscal year, guaranty agencies are again reimbursed for 100 percent of their claim payments to lenders until they reach the default rate thresholds.

The Department of Education

The Department of Education is responsible for administering the Stafford program and for overseeing the activities of the various participants. It pays lenders interest subsidies, and reimburses guaranty agencies for up to 100 percent of lenders' default claims. To partially offset program costs, the Department charges borrowers a 5 percent origination fee. It also receives payments from the guaranty agencies on collections from reinsured defaulted loans.

The federal government's risk on defaulted loans is, in general, the amount of monies it pays in reinsurance, less any amounts it receives in the subsequent collection of defaulted loans. Its risk in a worst case scenario could be 20 percent of outstanding loans. This assumes that all loans outstanding--approximately $50 billion--defaulted today, and all guaranty agencies would be insolvent. From a practical point, however, any expected loss would be much less. The net default rate for Stafford loans is about 11 percent; most borrowers repay their loans. In addition, the Department has said it historically has repaid reinsurance at approximately a 95.5 percent rate. Also, if guarantors become insolvent, their assets in any liquidation could also be available to offset lenders' defaulted loan claims. Therefore, any expected loss attributed to all guarantors becoming insolvent would be much less because not all outstanding Stafford loans would default.

STAFFORD PROGRAM PERSPECTIVE

The Department estimates that in fiscal year 1995, total loans outstanding will be about $70 billion. Now I would like to provide a further perspective on the Stafford program in terms of loan growth, defaults, and program costs.

Loan Growth

The Stafford program has grown during the 1980s, especially since 1983. The amount of new loans guaranteed[2] through fiscal year 1989 for the entire program increased 83 percent since 1983. Not unexpectedly, because PLUS and SLS loans were basically just starting during this period, their growth rates were high--407 percent and 1,832 percent, respectively. (See table 3.)

Table 3: Loan Volume Has Substantially Increased Since Fiscal Year 1983
(Dollars in millions)

Type of loan	Loans guaranteed Fiscal year 1983	Loans guaranteed Fiscal year 1989	Percent increase
Stafford	$6,537	$9,593	47
PLUS	147	746	407
SLS	110	2,125	1,832
Total program	$6,794	$12,464	83

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[2] Loans guaranteed represent commitments made to lenders by guaranty agencies. However, actual loan disbursements would be less in those instances where students decide not to enroll in school and the loan was cancelled.

Default Growth

Defaults have risen dramatically. Defaults for the total program increased 352 percent in the last 6 years. Stafford loan defaults went up 278 percent from fiscal year 1983 through fiscal year 1989, while PLUS and SLS loan increases were 6,525 percent and 112,730 percent, respectively. (See table 4.)

Table 4: Defaults Have Dramatically Increased Since Fiscal Year 1983
(Dollars in thousands)

	Default payments to lenders		
Type of loan	Fiscal year 1983	Fiscal year 1989	Percent increase
Stafford	$444,022	$1,679,000	278
PLUS	483	32,000	[a]
SLS	265	299,000	[a]
Total program	$444,770	$2,010,000	352

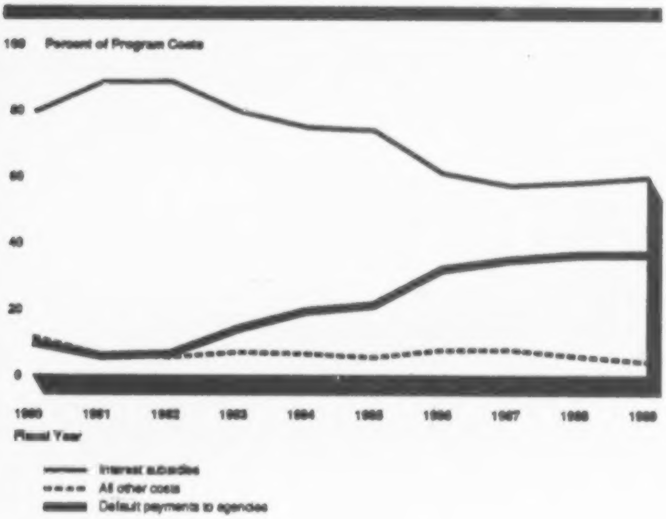
[a] Default rates for PLUS and SLS loans increased 6,525 percent and 112,730 percent, respectively, over the 6-year period. However, these loans were relatively new and the eligibility for SLS loans had been liberalized in the last 3 years. By all indications, default rates are rising rapidly for those two types of loans.

Although both loan volume and loan defaults have increased dramatically over the last 6 years, the increase in defaults has far exceeded the increase in loan volume. For example, as I pointed out earlier, total loans increased 83 percent from fiscal year 1983 through 1989, while defaults increased 352 percent--four times faster than loan volume. The Department attributes a large portion of these default increases to the four-fold increase in Stafford loans from 1977 to 1983.

Program Costs

As a portion of total program costs, default costs[3] have risen from about 10 percent in fiscal year 1980 to 36 percent in 1989. Interest subsidies have decreased as a portion of total costs, and were about 60 percent of the program's costs in 1989. Other costs, including the Department's expenses for other claims, such as death and disability, have leveled off to 4 percent of program costs in 1989. (See figure 1.)

Figure 1: Defaults Are Becoming A Greater Portion of Program Costs



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[3] The default costs represent payments to guaranty agencies.

CONCERNS ABOUT THE FINANCIAL CONDITION OF THE HIGHER EDUCATION ASSISTANCE FOUNDATION

I would now like to focus on the problems currently faced by HEAF. I want to first compare HEAF's loan and default volume with other guaranty agencies. Then, Mr. Chairman, I shall address the three areas about HEAF that the Committee is most interested in: (1) what is the risk faced by lenders who hold loans guaranteed by HEAF? (2) what is the risk faced by the Student Loan Marketing Association (Sallie Mae)? and (3) what costs may be incurred by the federal government if HEAF becomes insolvent?

HEAF's Loan Volume

While most guaranty agencies generally serve only one state, HEAF and United Student Aid Funds, Inc. (USAF), are national guarantors and have been designated by several states to serve as their guarantor. As a result, HEAF is the designated guarantor for the District of Columbia, Kansas, Minnesota, Nebraska[4], West Virginia, and Wyoming.

In recent years HEAF has been the largest guarantor in the Stafford program. However, as shown in table 5, HEAF's share of loans began to decline in fiscal year 1989, from over 20 percent in each of the previous 3 years, to 14.4 percent in fiscal year 1989. In addition, HEAF's share of new loans guaranteed continued to decline so far this year, representing 12.2 percent of all loans guaranteed during the first 6 months of fiscal year 1990.

HEAF attributed its decline in new loan guarantees to its decision in July 1988 to cease guaranteeing loans in 18 states because its loan portfolio mix that year was mostly (70 percent) for students attending proprietary schools. Default rates on loans made to these students are much higher than are default rates for students attending 4-year schools. HEAF said that the change made in 1988 reduced its 1989 portfolio of loans to borrowers attending proprietary schools to 35 percent, down from 70 percent.

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[4] The state of Nebraska has designated two guarantors, HEAF and the Nebraska Student Loan Program.

Table 5: HEAF Has Had the Largest Share of Loan Dollars Guaranteed
(Numbers are percentages)

	Fiscal year			
Agency	1986	1987	1988	1989
HEAF	21.9	27.6	26.9	14.4
USAF	6.4	8.4	10.3	12.8
California	7.9	7.7	8.0	9.6
New York	9.6	8.3	7.9	7.9
Pennsylvania	5.7	6.2	6.8	8.1

Source: Department of Education

HEAF's Default Volume

As the largest guarantor of student loans, HEAF is also the biggest payer of default claims to lenders. During the last 4 fiscal years, HEAF's share of default claims paid to lenders has increased significantly from 12.0 percent in 1986 to 38.7 percent in 1989. Table 6 shows that HEAF's share of default claims is much higher compared to the four agencies guaranteeing the next largest numbers of Stafford loans. In contrast, Pennsylvania's default share steadily declined during the period.

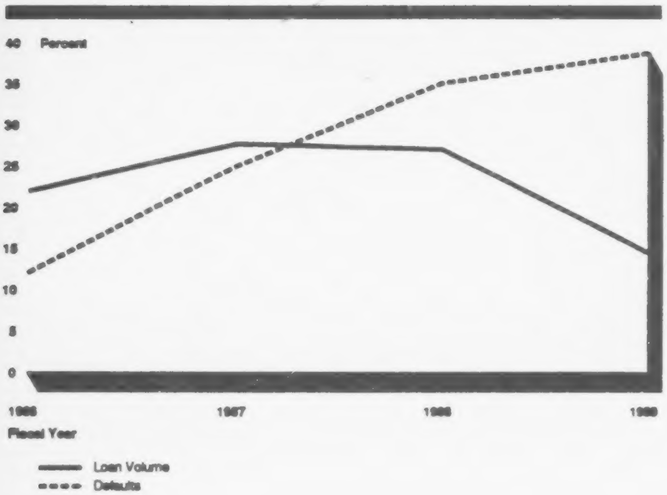
Table 6: HEAF Has Had the Largest Share of Default Dollars
(Numbers are percentages)

	Fiscal year			
Agency	1986	1987	1988	1989
HEAF	12.0	24.9	35.0	38.7
USAF	5.4	5.3	5.6	7.0
California	12.7	8.9	6.8	8.9
New York	15.1	11.7	9.4	9.8
Pennsylvania	6.7	4.8	3.7	2.6

Source: Department of Education

Figure 2 shows that HEAF's share of default claims paid to lenders increased as its loan volume remained steady and subsequently decreased.

Figure 2: HEAF's Share of Total Stafford Program Defaults Now Exceeds Its Share of Loan Volume



Source: Department of Education

Risk to Lenders with HEAF-Guaranteed Loans

Under normal circumstances, lenders are reimbursed 100 percent for default claims if they properly originate and service their student loans. As a result, lenders with HEAF-guaranteed loans are paid the full amount of their defaulted loans if they followed established procedures. HEAF told us that as of July 17, 1990, it had $8.8 billion in outstanding guaranteed loans. Therefore, if HEAF ceased operations that day, that amount--and any accrued interest--would be the maximum risk for these lenders on their loan portfolios if borrowers stopped making or never made any payments. This also assumes that the government would pay no reinsurance on lenders' default claims. Of course in a liquidation, HEAF's assets could be available to help offset lenders default claims. HEAF also reports that 10 lenders held about 75 percent of its outstanding loans as of July 17, 1990.

Risk to Sallie Mae

As I stated earlier, lenders have some risk in the Stafford program if they fail to follow proper procedures in originating and servicing a loan. Sallie Mae's risk would be no different than other holders of student loans. HEAF reports that Sallie Mae has the largest share of HEAF-guaranteed loans, almost $2.9 billion as of July 17, 1990.

Risk to the Federal Government

If HEAF should fail and is unable to meet its commitments to pay lenders for defaulted guaranteed loans, the question becomes: is the payment of lenders' default claims a responsibility of the federal government? Under the Higher Education Act, as amended, the Department of Education has no direct legal obligation to lenders if a guaranty agency, such as HEAF, becomes insolvent or otherwise fails to meet its obligations. The contract the

Department entered into with the guaranty agency does not extend to the lender--the Department is not insuring lenders. Therefore, the Department has no legal responsibility to pay lenders claims if HEAF should fail.

However, the Secretary of Education has broad legal powers in connection with the Stafford Student Loan Program which may be used in such cases. Although not required or obligated by the law to take any particular action, the Department could assert that it has the authority to pay lenders' claims on defaulted student loans.

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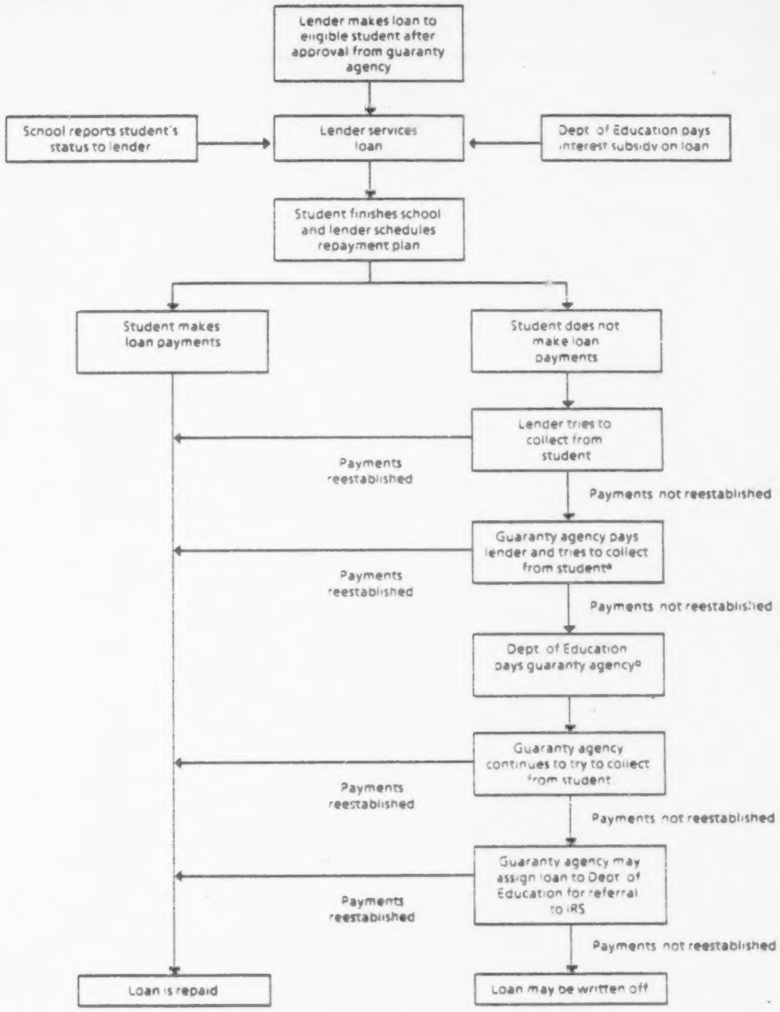
Mr. Chairman, that concludes my statement. My colleagues and I would be happy to answer any questions you or other Committee members may have.

Attachment

Life of a Stafford Loan


Lender makes loan to eligible student after approval from guaranty agency
School reports student's status to lender
Lender services loan
Dept. of Education pays interest subsidy on loan
Student finishes school and lender schedules repayment plan
Student makes loan payments
Student does not make loan payments
Lender tries to collect from student
Payments reestablished
Payments not reestablished
Guaranty agency pays lender and tries to collect from student[a]
Payments reestablished
Payments not reestablished
Dept. of Education pays guaranty agency[b]
Guaranty agency continues to try to collect from student
Payments reestablished
Payments not reestablished
Guaranty agency may assign loan to Dept. of Education for referral to IRS
Payments reestablished
Payments not reestablished
Loan is repaid
Loan may be written off

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[a] Guaranty agency pays 100 percent of the lender's claim, if the loan was serviced properly.

[b] The Dept. of Education pays reinsurance to the guaranty agency, up to 100 percent of the claim.

[c] The Dept. of Education may refer defaulted loan to IRS for income tax refund offset.

STATUTORY AUTHORITY TO ASSURE REPAYMENT

The **CHAIRMAN**. Mr. Frazier, does the Education Department have adequate statutory authority to assure lenders that they will be repaid for losses if their guarantor fails?

Mr. **FRAZIER**. Mr. Chairman, our reading of the statute says that the guarantee goes to the guaranty agency from the Department, and that the guaranty agencies have the responsibility for guaranteeing the student loans.

I think the question that you are raising is a very difficult question, and it is one that is being sorted out at this time. I honestly do not know if they have the authority to do so. I think the Department is struggling with that very question.

The **CHAIRMAN**. Well it is a pretty central question with this problem. I appreciate your honesty in answering it. So I take it that we do not have a clear answer right now.

Mr. **FRAZIER**. No, sir, Mr. Chairman.

The **CHAIRMAN**. I think that has got to get clarified promptly, because we do not want lenders backing away as we head into the new school year.

Mr. **FRAZIER**. Before coming up for our testimony we asked our general counsel to look into that particular issue, and it seems to us that the statute is unclear; that the Department does not have an obligation to the lender. However, they do have some authority that they could possibly wield to guarantee the loans.

REGULATORY AND SUPERVISORY AUTHORITY

The **CHAIRMAN**. Let me ask you, in your opinion does the Education Department have adequate regulatory and supervisory authority over the guarantors?

Mr. **FRAZIER**. I believe that they have adequate authority. However, whether they have sufficiently exercised its authority is another question. We believe that the Department of Education has the authority to regulate the guaranty agencies, and we have made some recommendations in the past that the Department take on additional responsibilities, such as retaining certain kinds of reserves.

Perhaps my colleague, Jay Eglin, can elaborate a little bit on that.

The **CHAIRMAN**. I would like to hear that.

Mr. **EGLIN**. Our reading of the law suggests that the Department does not have the explicit authority to regulate the guaranty agencies. The law does not really address that issue. It appears that the Department does have some general authority which it could use to regulate the agencies, or to provide some guidance.

And as Mr. Frazier mentioned earlier, we did provide some suggestions earlier on establishing guaranty agency cash reserves, because they were basically unregulated.

The **CHAIRMAN**. When was that done?

Mr. **EGLIN**. I believe it was in July 1986. There was a recommendation that we provided to the Secretary of Education.

The **CHAIRMAN**. And was it implemented, do you know?

Mr. **EGLIN**. No, sir.

The **CHAIRMAN**. It was not implemented?

Mr. EGLIN. No, sir.

The CHAIRMAN. Have you made any further attempt to try to get those kinds of safeguards in place? Or was it simply the one time in 1986 when you recommended it, and your recommendation was turned aside?

Mr. EGLIN. There was some action by the Budget Committee to provide guidance and guidelines to bring down some of the agency reserves several years ago, and I think that was just completed last year. There has been no further action in the last year, to my knowledge.

The CHAIRMAN. Would you send us a copy of whatever that set of recommendations was that you made to the Secretary?

Mr. EGLIN. Sure.

The CHAIRMAN. Were there discussions, a follow-up to the letter, or not?

Mr. EGLIN. The discussions evolved around the agencies. The financial picture of the agencies has changed in the last 4 to 6 years. At the time, they had considerably more reserves than they do today. There was concern about who owned the reserves, the agencies or the Federal Government.

The CHAIRMAN. Why have the reserves gone down?

Mr. EGLIN. Well, as HEAF has found out, and as the Department has testified, the number of loans in default has increased substantially. The reserves are a primary source of how the guaranty agencies pay their insurance claims to lenders.

The CHAIRMAN. And I believe we have established today that there is no requirement of a reserve that has to be maintained. Is that correct?

Mr. EGLIN. That is correct.

The CHAIRMAN. There probably should be, should there not?

Mr. EGLIN. Yes. And some states do provide some guidance to their agencies, but the Department does not.

The CHAIRMAN. In your view, did the Education Department do all that it could have to prevent or ease the situation constructively?

Mr. FRAZIER. Mr. Chairman, I do not know. I cannot really respond to that particular question, because I do not know what the Department of Education has done with regard to HEAF.

The CHAIRMAN. I think that we may have to find the answer to that question, and I appreciate your candor in saying that. This is a new problem.

Mr. FRAZIER. It is a new problem; that is correct.

The CHAIRMAN. But I think it would be useful to examine that and see if we cannot get an answer for that. So we will follow up with you on that.

Mr. FRAZIER. Yes, sir.

The CHAIRMAN. Do you know of any other guarantors that are in danger of failing?

Mr. FRAZIER. No, sir, we do not know.

The CHAIRMAN. Are there incentives out there that would cause a guarantor to maintain adequate capital?

Mr. FRAZIER. To maintain adequate capital? Well, if you are talking about the reserves, to our knowledge, there is not a requirement to maintain a certain reserve. That would be going back to the question that you were raising just a few moments ago. We believe that is the answer to getting the adequate capital for the guaranty agencies.

The **Chairman**. Well, I asked the question to establish for the record that it does not appear that we have a procedure in place that really structures and defines this question of, in effect, adequate capital or adequate reserves.

Mr. **Frazier**. Right.

The **Chairman**. And it seems to me that that is something we had better take care of, is it not?

Mr. **Frazier**. It appears to me that when the program was structured, a certain default rate was permitted before the guaranty agency would suffer loss. For example, an agency could lose up to 5 percent without suffering a loss. To offset these costs the agencies collected a one-time insurance fee of 3 percent of loans guaranteed. Besides that, the Department of Education pays the agencies an administrative fee and 30 percent of whatever the agencies collect on defaulted loans.

I think that when the program was structured in that particular way, funds from these fees would be sufficient to cover the agencies default costs.

The **Chairman**. Do you have any sense for what the overhead costs are in these guarantors? You probably heard me asking that question earlier.

Mr. **Frazier**. No, sir, I do not have an answer.

The **Chairman**. What is the exposure of banks? This overlaps an earlier question, but I want to ask it this way. What is the exposure of banks to student loan guarantors in general, and what would that exposure to banks be with respect to HEAF?

Mr. **Frazier**. Well, I can only answer that question in a very general way. Today there is about $50 billion in loans outstanding. If the banks have lenders who have properly serviced their loans, and if the guaranty agency is in place, there is very little exposure to the banks.

But if the guaranty agency disappears, the banks' exposure could change. The Federal Government, in effect, already insures about 80 percent of the loans. So the exposure to the banks without a guaranty agency could be about 20 percent. However, that goes back to the question of whether or not the Department of Education will take the option to insure the loans.

The **Chairman**. Do we know if there are particularly large concentrations at individual banks? Would you know that, offhand?

Mr. **Frazier**. There are a few banks that have most of the loans, and if you would turn to page 5 of my statement you will see HEAF's, outstanding loans.

Mr. **Crissman**. Mr. Chairman, 25 lenders hold approximately 54 percent of the loans outstanding. This is nationwide in the program.

The **Chairman**. Twenty-five lenders?

Mr. **Crissman**. Right.

The **Chairman**. They hold 54 percent of the total loans, is that right?

Mr. **Crissman**. Yes.

The CHAIRMAN. And you said that figure was approximately $50 billion? Was that the number, Mr. Frazier?

Mr. FRAZIER. That is correct.

The CHAIRMAN. Can you tell us what is the exposure of Sallie Mae to HEAF?

Mr. FRAZIER. We did look into that, and gross exposure is about $3 billion.

The CHAIRMAN. Now "gross" meaning what? Is there another way to look at it?

Mr. FRAZIER. That means that HEAF insures approximately $3 billion of Sallie Mae's portfolio. And this assumes that all loans would default, and that neither the guaranty agency or Federal Government would pay lenders' default claims.

COST TO GOVERNMENT IF HEAF FAILS

The CHAIRMAN. Do you have an estimate of the range of possible costs to the Government that HEAF's failure might bring about?

Mr. FRAZIER. No, sir. And that is because it is a very complex question. It depends on the assets of HEAF. It depends on the holders against those assets. And it is a very tough process to get through to make some estimate about the costs of the failure.

The CHAIRMAN. I know it would be difficult under any circumstances, but is the newness of this problem part of your answer?

Mr. FRAZIER. Certainly the newness, Mr. Chairman, is a part of the problem.

The CHAIRMAN. In a matter of weeks might you be in a position to give us a more precise estimate?

Mr. FRAZIER. Well, Mr. Chairman, we certainly will try. I do not know exactly how close we could get to an absolute answer, but we certainly could try in a couple of weeks to give you an answer.

The CHAIRMAN. Very good. I think you have given us what you can at this point, and I thank you for that. I am going to give you some questions to answer for the record.

The CHAIRMAN. I think we will excuse you now as a panel of witnesses, and I want to move to our final witness.

Mr. FRAZIER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Frazier.

Let me invite Mr. Hough, who is the president and CEO of the Student Loan Marketing Association, to come to the table.

Mr. Hough, let me just say that last evening we were in session in the Senate on the Farm bill until about 1 a.m. We started earlier this morning on that bill again. We had a hearing on this committee here earlier this morning that lasted some hours, interrupted by votes at different times, and I am very sensitive about mispronouncing people's names. I want to apologize for that in my haste earlier, but we are pleased to have you, and we would like to hear your comments at this time.

STATEMENT OF LAWRENCE A. HOUGH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, STUDENT LOAN MARKETING ASSOCIATION [SALLIE MAE], WASHINGTON, DC, ACCOMPANIED BY TIMOTHY GREEN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, STUDENT LOAN MARKETING ASSOCIATION

Mr. HOUGH. Thank you, Mr. Chairman.

Mr. Chairman, I am Lawrence A. Hough, president and chief executive officer of the Student Loan Marketing Association, better known to many as Sallie Mae. This afternoon I have with me Timothy Green, executive vice president and general counsel of our corporation.

Sallie Mae is a federally chartered, stockholder owned corporation which provides the Nation's largest single source of financing for postsecondary education. We were created by Congress in the Education Amendments of 1972. To foster our public mission, Sallie Mae is expected to provide leadership in the education credit markets to ensure the continuation of private capital availability for student loans.

We also serve the interests of our investors who are commercial lending institutions, educational institutions, and the general public. It is their continued confidence and continued investment in Sallie Mae that enables us to continue to accomplish our mission.

In carrying out this business purpose, our shareholders expect us to achieve a reasonable return on investment and not to assume risks which would adversely affect our ability to do so.

Since 1973, we have provided over $50 billion in funds and commitments for educational loans. This represents funding for more than 20 million student loans. Today the corporation, both by buying students loans and by providing collateralized advances to lenders to finance their loans, funds about 4 in 10 of all loans outstanding.

We are one of a very small number of financial corporations that has been given a AAA rating from the rating agencies. This rating does not rely on our GSE status, but reflects our "strong financial fundamentals." In 1981 when our obligations were guaranteed by the Department of Education, our credit rating was a single "A".

There are several types of risk potential in the financial operations of the secondary market such as Sallie Maes. I will review five that are defined as "most germane" both by Treasury and the GAO in their recent GSE studies of our institution.

INTEREST RATE RISK

The first, "interest rate risk," is present whenever there are significant gaps between the maturities or rate resets on a corporation's assets and liabilities. It has been our long-standing policy to eliminate this risk by maintaining a near-perfect match in asset and liability interest rate sensitivity with respect to our entire balance sheet.

CREDIT RISKS

Second, "credit risk." This includes issues such as asset quality, the borrower's ability to repay, the originator's ability to make good if we should take recourse against it because of an operating deficiency, and the quality of all collateral that secure our advances. I believe that there is general agreement that Sallie Mae poses little credit risk. Our asset quality is high because our mission of purchasing Government-guaranteed loans and taking them as collateral for loan advances is managed prudently at all times.

Because Sallie Mae provides liquidity to student loans— principally to commercial banks, none of which are "AAA"—we recognize the continuing necessity to fully collateralize our obligations from these institutions. Accordingly, all of Sallie Mae's credit extensions are made on a fully collateralized basis.

OPERATIONAL RISKS

The third area of risk are "operational risks," and these are especially important in servicing and are common in the student loan industry today. This risk element was very significant exacerbated in 1988 when the Federal Government issued new regulations, regulations which substantially complicated the requirements for "due diligence" efforts by lenders and guarantors in collecting loans, and there are penalties for noncompliance.

These new regulations have created additional cost to lenders in carrying loans into and through the repayment phase, as well as additional administrative burden, complexity, and risk. In short, operational deficiencies today can and do result in principal loss to lenders.

To address that risk, Sallie Mae spends well in excess of $100 million annually to service its student loans and to create and enhance the servicing technology we employ.

MANAGEMENT RISK

"Management risk," the fourth area, may be described as the risk that an enterprise fails to obtain management of sufficient quality to permit it to operate soundly. In keeping with a tradition of private corporation structure, the Board of Directors of Sallie Mae provides an active stewardship over the corporation and, with a highly qualified management team, together we have the responsibility for Sallie Mae's policies and performance.

The Board, in its diverse makeup, reflects the diversity of interests in the education credit industry. We are represented by banks, private colleges, public colleges, state guarantee agencies, insurance companies, and the general public. High regard for management is generally prevalent throughout the financial world.

LEGISLATIVE RISK

The fifth risk, and last, is "legislative risk." In the era of budgetary restraint in which this country now finds itself, this has led to numerous changes, both legislative and regulatory, in the Guaranteed Student Loan Program.

For example, title IV of the Higher Education Act has been amended nine times in the past 10 years. These constant modifications of programs cause delays of at least a year in the issuance by the Department of Education on the regulations implementing the changes. In general Sallie Mae is doing everything possible to identify and minimize the various types of risks to which it is subject.

With the advent of the new "due diligence" requirements of 1988 and the overall climate of risk shifting to the private sector, the potential cost of error has certainly increased.

Mr. Chairman, recently the Department of Education announced that one of the largest guarantors in the Federal loan program, the Higher Education Assistance Foundation, is experiencing financial difficulties. These difficulties represent problems for one guarantor. They are not indicative of systemic problems in the Student Loan Programs nor on the operations of any Government-sponsored enterprise.

More importantly, Sallie Mae believes that HEAF's financial condition poses no material risk to Sallie Mae. Student loan guarantee agencies such as HEAF, as you know, guarantee loans made by lenders in the Student Loan Programs against the risk of default. The Federal Government then reinsures the agencies.

HEAF is the guarantor of a portion of the student loans Sallie Mae owns. Our share of HEAF-guaranteed loans is about the same as our share of total guaranteed student loans throughout the program. The large majority of HEAF loans in the Sallie Mae portfolio are already in repayment and hence can be expected to experience insignificant default rates.

The default rate on the smaller, newer portion of the HEAF-guaranteed portfolio, can be reliably predicted on experience. The projected impact on Sallie Mae's balance sheets in earnings will not be material. In fact, like all guaranteed student loans, HEAF-guaranteed loans are reinsured by the Department of Education. Irrespective of HEAF's financial situation, Sallie Mae believes its claims on these loans will be honored. In fact, Tuesday the Secretary publicly stated that, and I quote, "While HEAF's problems are serious to that organization, they do not threaten the integrity of the nationwide Guaranteed Student Loan Programs or the loans now guaranteed by HEAF. Loans now guaranteed by HEAF will continue to be guaranteed."

Sallie Mae also extends collateralized loans to participants in the Student Loan Programs, in addition to purchasing loans. This activity increases liquidity to lenders and other loan program participants. Consistent with this activity, since 1984 we have extended collateralized advances to HEAF and its affiliates totalling $800 million. Of that amount, $200 million has been lent to HEAF itself. These advances are more than 100 percent collateralized with guaranteed student loans and Federal obligations.

This week, after the announcement of HEAF's difficulties, Sallie Mae stock experienced a market reaction. We believe this reaction was a result of the market's lack of information on which to assess the situation. Tuesday's press conference by the Secretary underscored the Federal Government's commitment to the program.

Mr. Chairman, Sallie Mae is proud of the role it has played in supporting the Federal Student Loan Programs. We have encouraged and fostered student credit, as Congress intended, and we have accomplished this task by prudently managing a well-financed, strongly capitalized corporation. Students, colleges, universities, lenders, and our shareholders have benefitted.

I would be happy to answer any questions you have.

The CHAIRMAN. Well, Mr. Hough, you became the CEO last week. It did not take you long to shake things up. [Laughter.]

Mr. HOUGH. I have noticed that, Mr. Chairman.

The CHAIRMAN. Well this gives you an opportunity today to put upon the record the statements that you have just made. I know you are new in this particular position, but I want you to express a judgment to the extent that you can.

Are you at all concerned about the adequacy of the Education Department's supervisory, regulatory, and enforcement powers with regard to student loan guarantors?

OVERSIGHT AND SUPERVISION

Mr. HOUGH. Mr. Chairman, the problem of supervision and oversight is, as you know, a complicated one. The program has a long history of a cooperative forging of policy and reaction to problems such as the problems that were identified by the witnesses before me. I have every confidence that the Department, working with the Hill, guarantee agency community, the lenders, and the secondary markets, colleges and universities, and all the component pieces, can put together the type of corrections that are needed to address some of the problems that have led to the situation with HEAF.

It is not unprecedented for us to have to work together to tune something that in the face of economic changes, demographic changes, and the like, have changed sort of the task at hand that is faced by title IV. I have every confidence that as a group there will be collective resolution of the difficulties.

The CHAIRMAN. What do you make of the data I was citing earlier about ultimate losses coming through to the Government having jumped up about $1 billion over a 2-year period of time?

Mr. HOUGH. Mr. Chairman, that situation is I believe a direct consequence of the dilemma that Senator Kassebaum spoke to, and that dilemma is the following:

If the guarantee agencies are in fact obligated to guarantee the loans presented to them of any student attending an eligible institution regardless of that student's ability to pay, and almost regardless of the ability of that student to get a job which provides the income to repay, and at the same time is limited somewhat in their ability to accumulate the reserve structure they need, we are going to have a problem such as was outlined.

It is that dilemma that has been addressed over the past by the common understanding in the industry that the loans in fact are guaranteed fully by the Government.

The CHAIRMAN. But you heard the GAO say that they are not quite sure that is right.

Mr. HOUGH. I am sure. I have listened to the Secretary, and I take him at his word in his commitment to fully back those guarantees. I would like to point out that, going back to when this program was largely a federally insured student loan program, the Government was on the hook for 100 percent.

What has happened in the transition, as we have pushed to the states greater authority, is that we have created this 80, and 90, and 100 percent reinsurance structure. It is my judgment that that is there to ensure another measure of discipline in the way the guarantee agencies go about their business. It is not there, and it is commonly understood not to be there, to reduce to the holder or the lender his insurance one iota. It is more there as a way of affecting solid management of the guarantee agency's responsibilities.

SAFETY AND SOUNDNESS REGULATOR

The CHAIRMAN. Well with losses that are rising at the rate I have already described, I think that there are at least questions that we still have not heard answers to yet today.

There have been recent studies by both the Treasury Department and the GAO that, as I am sure you know, recommend all GSE's have independent safety and soundness regulators. Now you have got a high rating at the moment, but you do not have an independent safety and soundness regulator.

Would you have any objection to having one?

Mr. HOUGH. Well let me start, Mr. Chairman, by observing that all of our debt issuance is approved by the Treasury. We are subject by statute to annual audit requirements. The Secretary of the Treasury is required to make a report on each audit to the President and the Congress. We have in our judgment already in place through statute provisions for oversight by both the Congress and the executive branch.

The CHAIRMAN. Well I guess then, by inference, you are saying that when the stock market had a serious case of heartburn with your stock this week, the market really did not know what the facts were? Is that the essence of what you are saying?

Mr. HOUGH. Yes, sir; exactly.

The CHAIRMAN. Where is the market today? Do you know?

Mr. HOUGH. I believe it is stable, or at least——

The CHAIRMAN. So are you back to where you were? Are you still down? You are stable at what level?

Mr. HOUGH. Stable at the level we started out this morning with, I hope, and I expect.

The CHAIRMAN. So where would you be today in terms of that opening level versus where you were before this all hit the news?

Mr. HOUGH. Probably, sir, down $6 a share, which is up 5 percent from the beginning of the year.

The CHAIRMAN. Down $6 a share?

Mr. HOUGH. Yes, sir.

The CHAIRMAN. So I guess what you are saying to us is you think the market just really does not understand the fact that this does not pose a real risk to you, and that when they figure it out, other things being equal, the market will go back to where it was? Am I to draw that conclusion?

Mr. HOUGH. Mr. Chairman, to say that it will go back to where it was sort of ignores where the market is as a whole.

The CHAIRMAN. Other things being equal.

Mr. HOUGH. But I suspect that the market will seek a level that is responsible to the underlying risks as we have addressed them.

The CHAIRMAN. And I am saying, assuming we hold that constant, you are saying you fully expect to be right back where you were, other things equal, when this information gets out there and the market digests it. Is that what you are telling us?

Mr. HOUGH. Absolutely.

The CHAIRMAN. Well, we will be able to find out soon. We have to wait until Monday, but we will have an opportunity to see that.

We are in the middle of a roll call vote.

Let me wish you well in your second week—[laughter]—as CEO, and all subsequent weeks, Mr. Hough.

Mr. HOUGH. Thank you, very much.

The CHAIRMAN. The committee stands in recess.

[Whereupon, at 5 p.m, the committee was adjourned, subject to the call of the Chair.]

[Additional material supplied for the record and responses to questions follow:]

STATEMENT
OF THE
CONSUMER BANKERS ASSOCIATION
ON
THE STAFFORD STUDENT LOAN PROGRAM
BEFORE THE
UNITED STATES
SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

July 26, 1990

The Consumer Bankers Association (CBA) appreciates the opportunity to present our views on the problem facing the Stafford Student Loan Program caused by the financial problems at the Higher Education Assistance Foundation (HEAF). CBA was founded in 1919 to provide a progressive voice for the retail banking industry. CBA represents approximately 800 federally insured banks and thrift institutions that hold more than 80 percent of all consumer deposits, and more than 70 percent of all consumer credit held by federally insured depository institutions. CBA members make over 70% of the loans originated by the top 100 lenders in the federally guaranteed student loan programs. CBA thanks Chairman Reigle for including our remarks as part of the written record on today's hearing.

The membership of the CBA includes virtually every major lender in the Stafford Student Loan programs authorized under Title IV of the Higher Education Act. Since the inception of these programs, private lenders have made available to student borrowers and their families over $60 billion to attend the colleges, universities and other postsecondary institutions of their choice. Students who meet the eligibility criteria established through federal statute and regulations developed by the Department of Education and are enrolled in accredited programs have been provided access to vital education and career opportunities through the receipt of this private loan capital.

It is through the establishment of the Stafford Student Loan programs that the Federal government has been able to bring to the American public real access to higher education opportunities. Stafford

Student Loans are supported by insurance provided through 55 state and national guaranty agencies. These agencies are supported by a program of reinsurance providing reimbursement by the Federal government.

CBA has watched with interest and concern the developments taking place within the Higher Education Assistance Foundation (HEAF) and the Department of Education's actions regarding this situation. We understand that the fact-finding on the HEAF situation is continuing as we meet. Pending announcement of a resolution, CBA remains cautiously optimistic that the Department will resolve the issues inherent in the financial problems of HEAF in the very near future in a manner that will maintain the full integrity of the guarantees issued by the agency. We are particularly pleased with the statement of the Secretary of Education, Lauro Cavazos, that "Loans guaranteed by HEAF will continue to be guaranteed." Most importantly, he has said to the lending community and to students and their families around the nation ..."this situation will not affect the ability of students to obtain loans, of lenders to make those loans or of guarantors to insure those loans." These are assurances which CBA member institutions interpret to be the Department's sincere attempt to calm the industry and bring the current situation to a quick, viable resolution. We believe the Department of Education is working to ensure full reimbursement to lenders for every eligible HEAF guaranteed loan which is presented for payment as a result of borrower default.

By all accounts, the Stafford Student Loan programs has been successful in meeting the public policy goal of promoting educational opportunity that prompted the Congress to enact the Higher Education Act. Banks of all different sizes now participate in the program and students from all socioeconomic levels now have access to needed funds to attend accredited higher education institutions.

Some press reports have described the HEAF situation in a manner that could convince students or their families that loans will not be available this fall. The lending community stands behind it's interest in making student loans available to eligible borrowers and we also believe, on the basis of statements made by Education Department officials, that the Department understands the need for stability in the operation of the program and the importance of it's stated commitment to taking timely action.

Effectively addressing the costly problem of defaults in the Stafford Student Loan programs has been an on-going goal of the Congress and the Department of Education for the past several years. Toward this goal, CBA has worked closely with legislators and agency officials , and other higher education groups, to address the default problem through statutory and regulatory refinement.

Clearly, the current default rate for Federally backed student loans is a cost to the taxpayer that is intolerable to even the most ardent supporter of student borrowing. CBA applauds the efforts of Senator Claiborne Pell, Chairman of the Subcommittee on Education, Arts believes steps taken by the Department of Education through the issuance of the Default Initiative regulations have helped to curb the escalation of default costs and restore public confidence and support for the loan programs.

In closing, CBA would like to reiterate the importance of a speedy resolution of the HEAF situation and of appropriate actions to ensure the continued viability of the Federal guarantee for all loans made under the Stafford Student Loan programs. Secretary Cavazos appears to have made a commitment to meet these objectives. The actions taken in the next week will definitively establish if this is the case.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
Franklin Frazier

GAO
United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

Q1. You stated that within a couple of weeks you might be able to produce an estimate of the range of possible cost to the government that HEAF's failure might bring about. Can you do that now?

A1. Recognizing that the federal government may incur additional costs related to a failure of the Higher Education Assistance Foundation (HEAF) to meet its financial commitments, the issue of what it might cost the federal government may evolve around whether the Department of Education decides to provide 100 percent reimbursement for HEAF-guaranteed loan default claims. The additional cost could theoretically range from nothing, if no more than 5 percent of HEAF guaranteed loans would default in fiscal year 1991, to about $1.6 billion if all of HEAF's loans defaulted, although both of these possibilities are highly unlikely. Most likely, additional federal costs would be between $175 million and $200 million. This estimate is developed based on the assumptions that (1) in fiscal year 1991 HEAF will file for federal reinsurance on the $400 million of default claims it paid to lenders in fiscal year 1990 for which it has yet to file reinsurance with the Department of Education, and (2) an additional $1.15 billion in loans are estimated to default and be paid to lenders in fiscal year 1991.

However, since the hearings the Department of Education has been working with the Student Loan Marketing Association (Sallie Mae), the program's largest secondary market lender, and several guaranty agencies to work out an arrangement to service HEAF's loan portfolio. The Department estimates that the cost of direct payments to Sallie Mae and the other agencies for servicing these loans will be less than $30 million. This cost would be in addition to the estimated $175 million to $200 million in federal costs resulting from the full federal reimbursement for defaulted HEAF-guaranteed loans, rather than reimbursements at the 80 percent and 90 percent levels for many defaults if HEAF had retained all of its portfolio.

Q2. It appears that guaranty agencies serve an important public function and the federal government cannot easily avoid standing behind the guarantees of those agencies. Yet, the federal government either does not have or does not use authority to ensure the safe and efficient operation of these agencies. Can you suggest some administrative or legislative remedies?

A2. As we stated in our testimony on July 27, 1990, the Higher Education Act of 1965, as amended, provides the Department of Education no direct legal obligation to lenders if a guaranty agency becomes insolvent or otherwise fails to meet its obligations. The Department's contract is with the guaranty agency and does not extend to the lender--the Department is not insuring lenders. Therefore, the Department has no legal responsibility to pay lenders' claims if an agency, such as HEAF, should fail.

However, the Secretary of Education has broad legal powers in connection with the Stafford Student Loan Program, which may be used in such cases. Although not required or obligated by the law to take any particular action, the Department could assert that it has the authority to pay lenders' claims on defaulted student loans.

If the Congress wishes to provide more guidance to the Secretary of Education, it could amend the Higher Education Act of 1965 consistent with a recommendation we made in our report on the need for criteria for establishing guaranty agency reserves (GAO/HRD-86-57, July 2, 1986). In that report we recommended that the Congress amend the Higher Education Act to require the Secretary to establish, in consultation with the guaranty agencies, criteria for the appropriate level of reserves the agencies should retain, based on the financial risks they face. The Department agreed with our recommendation, and we continue to support it.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PRESSLER FROM

Franklin Frazier

Q1. In December 1987, the Congress accepted the findings and recommendations of the General Accounting Office to take away $250 million in so-called excess reserves from guaranty agencies. In view of the financial situation of HEAF and the potential problem when the guaranty agencies' reserves are insufficient to meet the default expenses, does the GAO still maintain that its analysis of the reserve amount necessary for guaranty agencies was and is accurate and that it was a prudent decision to take away these reserves from guaranty agencies?

A1. The Omnibus Budget Reconciliation Act of 1987 implemented GAO's findings and recommendations and required the Secretary of Education to determine for each guaranty agency the amount of cash reserves it had at the end of fiscal year 1986 that exceeded each of five guidelines. The legislation required the Secretary to direct those agencies with excess reserves to eliminate them by one of several methods.

The law allowed the Secretary to waive the payment of part or all of an agency's reserves in excess of those allowed under the guidelines if: (1) the agency's financial position had deteriorated significantly since the end of the preceding fiscal year; (2) significant changes in economic circumstances, such as a change in the agency's cash reserves, or if the repayment of excess reserves would jeopardize the continuing operation of the agency; or (3) the recovery of excess funds would cause an agency to violate a contractual obligation to maintain a specific level of reserve funds. The law also limited the amount of excess reserves the Secretary could recover to $250 million. Total guaranty agency reserves exceeded $1 billion at the end of fiscal year 1986.

The guidelines included in the legislation were designed by GAO to allow each agency to retain sufficient reserves to survive the worst losses experienced by any guaranty agency in the 1981-86 period. They were also designed to be applied to the most recent fiscal year's financial data. Three of the five guidelines related to the agencies' insurance claims paid in, or the outstanding principal amount of loans guaranteed at the end of, the preceding fiscal year. This allowed agencies' reserves to rise as insurance claims and insured loan amounts increased. The guidelines were appropriate at the end of fiscal year 1986, and are appropriate today.

We know of no instance in which the application of the guidelines, as modified by an agency's appeal to the Secretary based on one of the reasons listed above, jeopardized the continued operation of a guaranty agency.

In the case of HEAF, the guidelines allowed it to keep cash reserves of $35 million, of the nearly $46 million it held, at the end of fiscal year 1986--a year in which it paid about $88 million in defaulted loan claims. If the guidelines were applied at the end of fiscal year 1989, a year in which HEAF paid about $750 million in claims, HEAF would have been allowed to keep cash reserves of $300 million and it would have had no excess reserves.

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF LEGISLATION AND CONGRESSIONAL AFFAIRS

September 28, 1990

Honorable Donald W. Riegle, Jr.
Chairman
Senate Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are Under Secretary Ted Sanders' responses to HEAF-related questions you submitted in follow-up to his July 27 appearance before the Senate Committee on Banking, Housing and Urban Affairs. Also enclosed are numerous charts and guarantee agency financial statements which you requested.

Please let me know if the Department can provide you with any further information or assistance on this important issue.

Sincerely,

Nancy Mohr Kennedy

Nancy Mohr Kennedy
Assistant Secretary

Enclosures

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-3100

Questions for Ted Sanders
From Senator Donald W. Riegle, Jr.
July 27, 1990

RESPONSES TO QUESTIONS POSED BY SENATOR DONALD W. RIEGLE, JR.

Q.1 You stated that there are 5 to 7 guaranty agencies besides HEAF that are in a weakened condition. What specific steps is the Department of Education taking to monitor their condition?

A.1 As we indicated previously, there are a few guarantee agencies experiencing what we believe are short term cash flow problems, although there is, to the best of our knowledge, no other guarantee agency facing problems similar to HEAF's. The Department has completed a preliminary analysis of the guarantee agencies, and is currently assigning program review teams to undertake comprehensive reviews of several of the agencies. The Department has engaged the services of a financial management firm to assist ED staff in reviewing the financial aspects of the guarantee agencies. The financial analyses that will be provided by this firm will also be used to support the Department's program review teams.

Q.2. Please provide HEAF's balance sheet as of June 30, 1990.

A.2. A copy is attached.

Q.3. Please provide HEAF's financial statement of operations for the most recent year available.

The statements should include a listing of HEAF's costs and revenues by category, any outside funds acquired, and HEAF's net increase in reserves.

A.3. Copies of the latest financial statement submitted to the Department is attached.

Q.4 Please provide annual data from 1980 through 1990 on guaranty agency reviews and audits by the Department of Education, including the number of reviews, the size of the staff conducting such reviews, and the amount spent on such reviews. Please provide the same data for reviews of lenders and institutions.

A.4 The attached chart shows the number of institutional, lender, and guarantee agency reviews conducted by OSFA staff from 1981 to 1989. Data provided begins with fiscal year 1981 and corresponds to the program year 1980-81. Estimates are provided for fiscal years 1990, 1991, and 1992. The second chart shows the staffing levels for OSFA regional offices for the years 1981 to 1990. The third chart shows the costs for these reviews.

In addition to reviews by OSFA, the Office of the Inspector General conducts audits of guarantee agencies. The specific number of OIG audits is included in the final chart. However, staffing levels and the amount spent on the reviews is not available.

Q.5 What criteria are used to evaluate the financial and administrative strength of guarantee agencies?

A.5 The Department has completed a preliminary analysis of the guarantee agencies' financial condition. A preliminary judgment of the financial condition of each guarantee agency was made based on its potential to incur income or asset losses in the following areas: the volume of new loans the agency has guaranteed (paying close attention to potentially high-risk proprietary school loans) and whether that volume had increased or decreased; the agency's cumulative cash reserves and whether the agency has experienced a decline in those reserves; the agency's overall loan volume and whether that volume is increasing or decreasing; and the agency's reinsurance rate and whether it was reduced during the most recent three-year period due to loan defaults.
The Department is also considering the following criteria relating to administrative condition: ability to carry out assigned functions; ability to collect on defaulted loans; ability to provide required reports to the Department; and ability to provide loan guarantees in a timely fashion.

The Department also reviews the biennial audit of an agency's financial condition and its compliance with program regulations. With the help of our financial advisor, the Department is developing criteria and a model to test the financial strength of guarantee agencies.

Q.6 What enforcement powers do you have if a guaranty agency is not in compliance with laws, rules, or regulations? If it is not competently managed? If its costs are excessive?

A.6 The Department has a limited number of enforcement powers at its disposal. To enhance the enforcement powers described below, the Department is requesting legislative changes that would give the Department broader oversight and enforcement authority over the guarantee agencies when Federal interests are at stake.

Currently, when it learns that a guarantee agency is not in compliance with program requirements, the Department may withhold payments due to the agency, impose fines, require the agency to refund all or a portion of the reinsurance payments made with respect to loans that have not been properly administered, or terminate the agency's participation agreement if there has been a violation of law or fraud has been committed.

The Department may also require the assignment to it of all or a portion of a guarantee agency's portfolio of defaulted loans when the Secretary determines that such action is necessary to protect the Federal fiscal interest. The agreement between a guarantee agency and the Secretary also specifies that if the agency fails or is unable to carry out its obligations or fails to comply with statutory or regulatory requirements, the Secretary may require that no further loans be made under the agency's program until corrective action has been taken by the agency and approved by the Department.

However, the Department has no authority to control or review the amount of an agency's administrative expenses. In fact, since Federal administrative allowances are statutory entitlements (1 percent of new loan volume, and a minimum of 30 percent of collections), there is little incentive for restraint below this reimbursement level.

Q.7 Please provide available information -- such as type of business, balance sheets, and profit statements -- of for-profit affiliates of HEAF. Does the Education Department audit transactions between HEAF and its for-profit affiliates? Does the Department have any regulatory authority over any of these affiliates?

A.7 The Department regulates the activities of guarantee agencies, which are State or nonprofit private organizations. The Department has no authority to regulate the for-profit affiliates of a guarantee agency, such as HEAF, nor does it generally audit or review transactions between HEAF and those affiliates. However, we hold the guarantee agency accountable for the actions of its agents -- for example, those companies with which it contracts. The guarantee agency agreement also requires the guarantee agencies to monitor their lenders and institutions. A for-profit affiliate is not required to submit financial information or other statements to the Department. However, one of HEAF's for-profit affiliates is a loan servicer. Therefore, the Department would, as part of a regular lender review, examine the servicing activities of this affiliate to determine if the loans are being serviced in accordance with regulatory requirements. There is no prohibition against guarantee agency officers or staff having an ownership interest in such for-profit contractors, while there is a prohibition in the case of ED employees.

Q.8 Should states or affiliated for-profit companies be required to maintain an adequate level of reserves in their associated guaranty agencies?

A.8 The Department believes that a minimum level of reserves is essential to the continued sound operation of any entity and is examining this area to determine whether legislative proposals are appropriate.

Q.9 How much does the chief executive officer of each guarantee agency get paid?

A.9 This information is not currently reported to the Department.

10, 11, 12

Q.10 I am concerned about defaulted student loans held by defunct thrifts. Please provide the total amount of student loans held by thrifts in conservatorship or receivership. How much of that total is currently in default? Is the Education Department satisfied that these loans are being serviced properly?

A.10 The Resolution Trust Corporation (RTC) has informed us that it holds approximately $500 million in Guaranteed Student Loans. The amount of that portfolio in default is unknown. Some of these loans may not have been properly serviced because of the problems associated with the lender's failure and subsequent takeover by the RTC, but the volume of loans involved is not known.

The Department is working with the RTC to ensure that these loans are serviced properly and to assist the RTC to sell them to eligible lenders at a fair price, minimizing the cost to the Federal Government.

RESPONSE TO QUESTION POSED BY SENATOR LARRY PRESSLER

Q. In December 1987, Congress accepted the findings and recommendations of the General Accounting Office to take away $250 million in so-called excess reserves from guarantee agencies. In view of the financial situation of HEAF and the potential problem when the guarantee agency's reserves are insufficient to meet the default expenses, does the GAO still maintain that its analysis of the reserve amount necessary for guarantee agencies was and is accurate and that it was a prudent decision to take away these reserves from guarantee agencies? (I also would appreciate receiving the comments of Mr. Sanders on the subject of this question.)

A: The Department cannot speak for the General Accounting Office on this issue. The Department believes that the excess reserves that were recovered are the property of the Federal Government and should have been reclaimed. Agencies were able to appeal the statutory requirement under section §422(e) of the Higher Education Act of 1965 to repay excess cash reserves. Each agency that appealed was provided ample opportunity to submit documentation and meet with us to explain why it believed it qualified for a waiver to the spend-down of its reserves as provided under the provisions of the law. Many agencies presented convincing arguments to support their waiver requests, and the Department ultimately granted more than $53 million in waivers to those agencies. HEAF, for example, received the largest waiver from the Department, more than $16 million, and therefore was required to repay only $1.4 million. This represented a very small amount of HEAF's reserves, and in no way contributed to HEAF's subsequent financial problems.

Student Financial Assistance
Program Reviews

The Office of Student Financial Assistance (OSFA) conducts onsite program reviews of participating institutions, lenders and guarantee agencies. The purpose of these reviews is to evaluate compliance with student financial assistance program regulations. As a result of these reviews, the Department may assess liabilities and fines, require corrective action or initiate termination action in cases of serious program abuse or fraud.

Program reviews are conducted by OSFA staff in ten regional offices. A typical institutional or lender review lasts one week and involves from one to three reviewers. A guarantee agency review is more complex and generally involves five to six reviewers. Reviewers select samples of student files and determine whether the students were eligible for the grants or loans made and that all regulatory requirements were met and documented. The reviewers also evaluate whether the institution is maintaining proper fiscal records and controls over funds and that financial reports submitted to the Department are accurate.

OSFA selects schools and lenders for review based on various indicators of problems and other priority factors: high GSL default rates, high or increasing loan volume, failure to submit audits, length of time from last program review, complaints from students, etc. Lenders are selected for review based on size, length of time from last review and other known problems. Guarantee agencies are reviewed at least once every three years.

After a review, institutions receive a written report of the review findings and required corrective actions. Institutions may appeal liability assessments and obtain a hearing before an administrative law judge.

In addition to regular program reviews, SFA staff participate in many other types of compliance activities. They provide technical assistance to the Office of the Inspector General and participate in joint reviews and investigations. OSFA staff also coordinate with Guarantee agencies which also conduct reviews of lender and schools. When serious program violations are found, institutions are placed on a system of payment by reimbursement. Under this system, funds are released to schools only after proper documentation have been submitted and reviewed by the SFA regional office. This is a very labor intensive activity, but one that is highly effective in preventing abuse of funds.

The attached chart show the number of program reviews conducted between 1981 and 1989. Estimates are provided for 1990, 1991 and 1992. Also attached is a copy of OSFA's institutional program review guide and a copy of OSFA review guide for lenders.

September 13, 1990

Department of Education
Student Financial Assistance
Program Reviews

FISCAL YEAR	INSTITUTIONAL REVIEWS	LENDER REVIEWS	GUARANTEE AGENCY REVIEWS*
1981	1,058	909	10
1982	510	802	10
1983	648	773	10
1984	721	763	10
1985	763	675	10
1986	417	463	10
1987	372	222	8
1988	677	282	10
1989	788	519	13
1990 (estimate)	1,050	730	24

* From FY 1981-86, Guarantee Agency reviews were not tracked separately. These numbers are estimates.

OSFA Regional Staffing for Program Review

(a) FY	(b) Nonsup. IR	(c) Nonsup. LR	(d) Sup. IR	(e) Sup. LR	(f) Total
1981	55	36	10	*	101
1982	47	34	10	*	91
1983	49	32	10	*	91
1984	54	37	10	*	101
1985	56	39	10	*	105
1986	52	33	10	*	95
1987 ceiling	56	22	10	6	94
1987 on board	55	21	10	6	93
1988 ceiling	55	22	10	6	93
1988 on board	52	21	10	6	89
1989 ceiling	91	39	22	6	158
1989 on board	83	36	14	6	139
1990 ceiling	91	39	22	6	158
1990 on board	86	36	22	6	150

* Prior to the 1986-1987 reorganization, a single person supervised both institutional (school) review and lender/guarantee agency review in nearly all regions.

Legend:

(a) Fiscal Year
(b) Nonsupervisory Institutional Reviewers
(c) Nonsupervisory Lender Reviewers
(d) Supervisory Institutional Reviewers
(e) Supervisory Lender Reviewers

JUL 31 1990

August 27, 1990

Amounts Spent by OSFA Regional Offices for Program Review Travel
Fiscal Years 1981 - 1990

FY 1981 - $304,092
FY 1982 - 221,663
FY 1983 - 350,198
FY 1984 - 352,529
FY 1985 - 349,366
FY 1986 - 136,034
FY 1987 - 322,022

A breakdown between institutional and lender/guarantee agency review expenditures is not available for FY 1981 through 1987.

	Inst. Review	Lender/GA Review	Total
FY 1988 Actual	$297,308	$147,280	$444,588
FY 1989 Actual	391,905	203,212	595,117
FY 1990 as of 7/31/90	517,416	275,275	792,691
FY 1990 Est. Total	621,000	330,000	951,000

DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Analysis of Audits Issued (1)

	FY 90*	FY 89	FY 88	FY 87	FY 86	FY 85
Postsecondary Education Institution Audits	32	55	23	19	00	24
No. of Lender Audits	00	09	01	06	00	02
No. of Guarantee Agency Audits	09	04	02	05	01	06

* As of 8/21/90

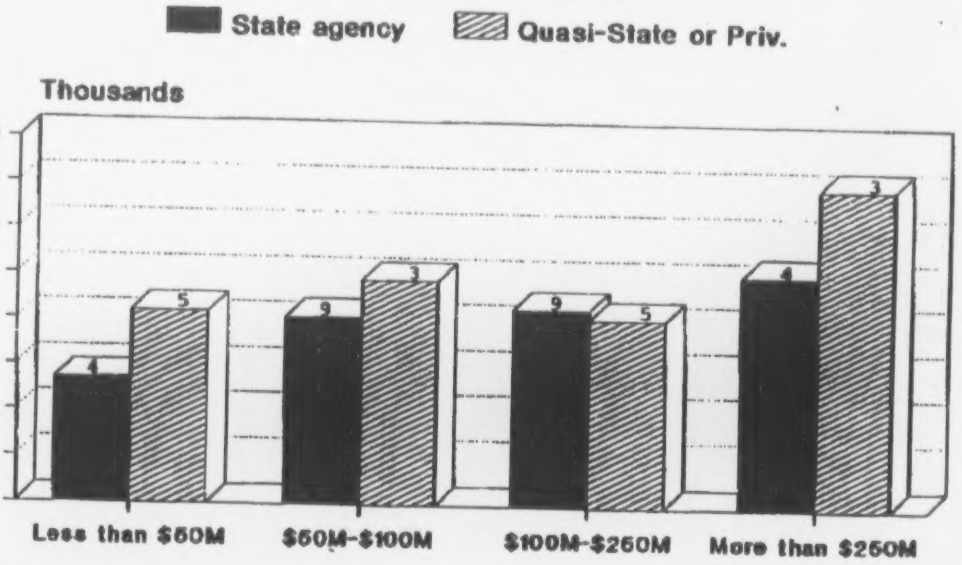
(1) Performed by ED OIG

(2) 20 Surveys of lenders were contracted for in FY 1989 and conducted by a CPA firm in FY 1990. Another 20 surveys of lenders were contracted for in FY 1990 and are currently in process. Additional contract work at lenders, guarantee agencies and secondary markets being contemplated.

(3) Above exludes required cyclical audits done by non-Federal auditors.

1990 SALARIES OF GUARANTY AGENCY HEADS

By Volume Guaranteed



Total: State-28; Quasi-State-5; Pvt-11

HEAF

WASHINGTON, D.C.

KANSAS

MINNESOTA

NEBRASKA

WEST VIRGINIA

WYOMING

HIGHER EDUCATION ASSISTANCE FOUNDATION

REPORT ON AUDITS OF FINANCIAL STATEMENTS
for the years ended September 30, 1989 and 1988

Coopers
&Lybrand

Certified Public Accountants

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Coopers
&Lybrand

certified public accountants

REPORT OF INDEPENDENT ACCOUNTANTS

To the Directors of
Higher Education Assistance Foundation:

We have audited the accompanying balance sheets of Higher Education Assistance Foundation as of September 30, 1989 and 1988 and the related statements of revenues and expenses and changes in fund balance, and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Higher Education Assistance Foundation as of September 30, 1989 and 1988, and the results of its operations, and the changes in its financial position for the years then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand

St. Paul, Minnesota
December 11, 1989, except for
Note 12 as to which the
date is December 28, 1989

HIGHER EDUCATION ASSISTANCE FOUNDATION

BALANCE SHEETS
as of September 30, 1989 and 1988

ASSETS	1989	1988
Current assets:		
Cash and investments	$ 10,537,343	$ 19,499,709
Accrued interest and accounts receivable	17,768,002	20,956,978
Claims reimbursements receivable	213,984,105	187,576,244
Student loans	12,130,000	6,950,000
Total current assets	254,419,450	234,982,931
Fixed assets and software, less accumulated depreciation and amortization of $3,678,843 in 1989 and $1,567,125 in 1988	22,813,355	17,390,905
Student loans	29,252,000	12,350,000
Total assets	$306,484,805	$264,723,836

The accompanying notes are an integral part of the financial statements.

LIABILITIES, NET DEFERRED REVENUE AND FUND BALANCE	1989	1988
Current liabilities:		
Accounts payable and accrued expenses	$ 29,374,283	$ 32,742,899
Accrued interest payable	1,324,064	165,807
Notes payable	186,629,034	97,000,000
Book overdraft	14,821,789	
Total current liabilities	232,149,170	129,908,706
Deferred guarantee fee revenue, net of deferred reinsurance fees	47,504,943	53,989,755
Fund balance	26,830,692	80,825,375
Total liabilities, net deferred revenue and fund balance	$306,484,805	$264,723,836

HIGHER EDUCATION ASSISTANCE FOUNDATION

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN FUND BALANCE

for the years ended September 30, 1989 and 1988

	1989	1988
REVENUES		
Guarantee fees	$ 36,215,979	$31,689,250
Collection retention	21,583,478	15,058,609
Administrative cost allowance	18,122,372	31,809,021
Interest	3,016,467	3,464,423
Servicing fees	421,126	593,797
Total revenues	79,359,422	82,615,100
EXPENSES		
Loan defaults	52,593,651	20,606,039
Personnel and office	36,259,436	31,888,364
Outside services	19,632,129	13,900,025
Reinsurance fees	8,810,133	5,763,237
Data processing services	8,548,049	6,193,990
Interest	5,398,989	502,120
Depreciation and amortization	2,111,718	857,819
Total expenses	133,354,105	79,711,594
Excess (deficit) of revenues over expenses	(53,994,683)	2,903,506
Fund balance, beginning of year	80,825,375	77,921,869
Fund balance, end of year	$ 26,830,692	$80,825,375

The accompanying notes are an integral part of the financial statements.

HIGHER EDUCATION ASSISTANCE FOUNDATION

STATEMENTS OF CHANGES IN FINANCIAL POSITION
for the years ended September 30, 1989 and 1988

	1989	1988
Cash provided:		
Excess (deficit) of revenues over expenses	$(53,994,683)	$ 2,903,506
Add items not affecting cash:		
Depreciation and amortization	2,111,718	857,819
Change in:		
Accrued interest and accounts receivable	3,188,976	2,764,409
Claims reimbursements receivable	(26,407,861)	(43,296,069)
Accounts payable and accrued expenses	(3,368,616)	3,135,129
Accrued interest payable	1,158,257	165,807
Book overdraft	14,821,789	(39,600,000)
Deferred guarantee fee revenue, net of deferred reinsurance fees	(6,484,812)	8,366,612
Cash used by operations	(68,975,232)	(64,702,787)
Student loan principal receipts	5,113,500	
Proceeds from notes payable	240,236,078	158,000,000
Repayments on notes receivable		67,818,137
Total cash provided	176,374,346	161,115,350
Cash applied:		
Student loan recoveries	27,195,500	19,300,000
Payments of notes payable	150,607,044	61,000,000
Issuance of notes receivable		55,975,026
Expenditures for fixed assets and software	7,534,168	12,890,029
Total cash applied	185,336,712	149,165,055
Increase (decrease) in cash and investments	(8,962,366)	11,950,295
Cash and investments, beginning of year	19,499,709	7,549,414
Cash and investments, end of year	$ 10,537,343	$ 19,499,709

The accompanying notes are an integral part of the financial statements.

HIGHER EDUCATION ASSISTANCE FOUNDATION
NOTES TO FINANCIAL STATEMENTS

1. Description of Business:

Higher Education Assistance Foundation (HEAF) is a nonprofit corporation operating nationwide as a guarantee agency under the federal Guaranteed Student Loan Program (the Program). HEAF is a member of the HEAF group of organizations, a constellation of nonprofit companies which provides student loan guarantees and processing services to commercial lenders and loans to postsecondary education students and their parents across the country under the Program.

The Program was established by Congress as a means of making loans available to students attending colleges, universities, vocational and technical schools and other postsecondary educational institutions and to parents of such students. Guaranteed loans may be made by commercial lenders such as banks and savings and loan associations or by statewide lending entities. The Program provides for HEAF to guarantee the repayment of principal and accrued interest to the lender for each eligible loan. HEAF also conducts activities to keep lenders informed about the Program, to encourage lender participation in the Program and to assist lenders in performing certain administrative functions related to the Program.

In addition to its guarantee agency operations, HEAF provides management and loan processing services to statewide lending entities and loan origination and disbursement services to lenders.

2. Accounting Policies:

GUARANTEE FEE REVENUE:

A guarantee fee is collected from borrowers at the time of loan disbursement. Guarantee fee revenue is recognized on a straight-line basis over the estimated life of a loan which ranges from 44 months to 56 months.

COLLECTION RETENTION:

Federal law provides for the Guarantor to retain 30% of recoveries on previously defaulted loans. The collection retention revenue is recognized in the year of recovery.

ADMINISTRATIVE COST ALLOWANCE:

Consistent with federal law, HEAF receives an administrative cost allowance equal to 1% of the volume of loans guaranteed in 1989 and 1988.

2. Accounting Policies (continued):

LOAN DEFAULTS:

Loan defaults incurred prior to year end and in excess of federal reinsurance, less estimated net recoveries realizable on defaulted student loans, are charged against current operations. For the year ended September 30, 1988, the value of net recoveries realizable on defaulted student loans was revised (see Note 3, Change in Estimate).

Annual default rates for purposes of the application for federal reinsurance are calculated on a state-by-state basis by dividing default claims for the fiscal year by the original guaranteed amount of loans in repayment at the beginning of the fiscal year. Federal reinsurance payments are made to HEAF according to the following schedule:

Annual Default Rate	Federal Reinsurance
0% to 5%	100%
More than 5% but less than or equal to 9%	100% of claims through 5% and 90% of claims over 5% but less than or equal to 9%
Over 9%	100% of claims through 5% and 90% of claims over 5% but less than or equal to 9% and 80% of claims over 9%

REINSURANCE FEES:

The federal government charges a reinsurance fee ranging from .25% to .50% of the principal amount of loans guaranteed during the year. Reinsurance fee expense is recognized on the same basis as guarantee fee revenue.

INVESTMENTS:

Investments, which consist principally of securities of the federal government or its agencies, high grade commercial paper and collateralized repurchase agreements, are carried at amortized cost which approximated market value as of September 30, 1989 and 1988.

STUDENT LOANS:

Student loans consist of the estimated realizable value of recoveries in excess of federal reinsurance on defaulted student loans (see Note 3, Change in Estimate).

HIGHER EDUCATION ASSISTANCE FOUNDATION
NOTES TO FINANCIAL STATEMENTS, Continued

2. Accounting Policies (continued):

FIXED ASSETS AND SOFTWARE:

Fixed assets and computer software are carried at cost less accumulated depreciation and amortization and are being depreciated and amortized on a straight-line basis over their estimated useful lives of three to ten years.

BOOK OVERDRAFT:

Book overdraft represents checks written in excess of the book cash balance which had not cleared the bank at September 30, 1989. HEAF had available a discretionary line of credit to fund these disbursements (see Note 7).

INCOME TAXES:

HEAF is a tax-exempt organization under the provisions of Internal Revenue Code Section 501(c)(4) and, accordingly, no provision for income taxes has been made in these financial statements.

3. Change in Estimate:

For the year ended September 30, 1988, the estimated realizable value of defaulted student loans was revised as the result of additional experience in the collectibility of defaulted student loans. This resulted in increasing the estimated value of recoveries in excess of federal reinsurance by $19,300,000 in 1988. Of that amount, $8,500,000 related to defaults occurring prior to 1988.

4. Restricted Assets:

In accordance with agreements with lenders, deposits are made to a restricted guarantee account designated the Guarantee Fund. Deposits to the Guarantee Fund met all funding requirements during the years ended September 30, 1989 and 1988.

Amounts on deposit in or accruing to the Guarantee Fund may be withdrawn only for the purpose of paying claims. These restricted assets amounted to $52,195,553 and $82,671,822 at September 30, 1989 and 1988, respectively.

HIGHER EDUCATION ASSISTANCE FOUNDATION
NOTES TO FINANCIAL STATEMENTS, Continued

5. Balance Sheet Information:

	1989	1988
Accounts payable and accrued expenses		
Claims incurred but not due for payment	$ 231,040,754	$ 168,398,000
Estimated reinsurance recoveries	(222,670,754)	(161,471,000)
	8,370,000	6,927,000
Recoveries due Department of Education	9,586,487	6,910,715
Other accounts payable and accrued expenses	11,417,796	18,905,184
Total	$ 29,374,283	$ 32,742,899

6. Lease Commitments:

HEAF leases office space, equipment and automobiles under operating leases. A portion of the office space is leased from a partnership of which one partner is on HEAF's Board of Directors. These leases require monthly rentals of $40,500 and have terms of thirty years expiring in the year 2014. HEAF also makes monthly payments to this partnership for certain other office space. All other leases expire over the next three years. Lease expense was $4,553,407 and $3,647,754 for the years ended September 30, 1989 and 1988, respectively. The minimum future lease commitments under noncancellable operating leases as of September 30, 1989 are:

Fiscal Year	Amount
1990	$ 1,754,600
1991	995,400
1992	629,100
1993	518,400
1994	507,600
Thereafter	10,341,000
Total minimum commitment	$14,746,100

7. Notes Payable:

A discretionary line of credit was available in 1989 and 1988 from several commercial lending institutions in the form of revolving promissory notes payable on demand with payment in full due no later than December 31, 1989 and 1988, respectively. The notes bear daily interest, payable monthly, at prime rate which was 10.5% at September 30, 1989.

7. **Notes Payable (continued)**:

The lines of credit were limited to maximum borrowings of $175,000,000 in 1989 and $120,000,000 in 1988. Borrowings amounted to $150,129,034 and $97,000,000 at September 30, 1989 and 1988, respectively. Claim reimbursements receivable from the U.S. Department of Education serves as collateral on the promissory notes.

HEAF had demand notes due to HEAF group members in the amount of $36,500,000 at September 30, 1989. Daily interest on the notes was payable quarterly at .75% or 1.35% over the coupon equivalent yield of the most recently auctioned thirteen-week United States Treasury Bills.

8. **Profit Sharing and 401(k) Plans**:

Two defined contribution plans cover substantially all employees. Contributions to the plans are at the option of the employer. Plan expense was $1,449,554 and $912,610 for the years ended September 30, 1989 and 1988, respectively.

9. **Related Party Transactions**:

HEAF is a party to a mutual support agreement with certain other members of the HEAF group of organizations. This agreement provides for the mutual guarantee of certain obligations of the other members of the HEAF group that have entered into the agreement and may be terminated by the HEAF Board of Directors but only with respect to certain written obligations which did not exist as of the date of termination.

HEAF has guaranteed student loans in the approximate amount of $642,383,000 for corporations which are members of the HEAF group of organizations which represents approximately 7% of the total loans guaranteed by HEAF.

HEAF receives certain services from members of the HEAF group for which it incurred costs of $2,055,000 in 1989 and $1,500,000 in 1988. HEAF has also guaranteed indebtedness and lease obligations of HEAF group members in the approximate amount of $515,000 as of September 30, 1989.

HEAF held demand notes due from HEAF group members, the proceeds of which were used to acquire student loans. Daily interest was payable quarterly at .75% over the coupon equivalent yield of the most recently auctioned thirteen-week United States Treasury Bills. Interest income from such demand notes was $166,030 and $1,482,534 for the years ended September 30, 1989 and 1988, respectively. As of September 30, 1989 and 1988, these amounts had been repaid.

9. Related Party Transactions (continued):

HEMAR Service Corporation of America provides data processing and certain other services to HEAF. HEAF incurred expenses of $8,164,560 in 1989 and $6,466,490 in 1988 for such services.

Certain members of management of HEAF also act in similar capacities for the aforementioned organizations.

10. Contingencies:

HEAF is party to various legal actions arising in the ordinary course of business. In the opinion of management, the amount of ultimate liability, if any, with respect to these actions will not have a material affect on the financial position of HEAF.

11. Reclassifications:

Certain reclassifications have been made to the 1988 financial statements in order to conform with the 1989 presentation. These reclassifications have no effect on the previously reported fund balance or excess of revenues over expenses.

12. Subsequent Event:

On December 28, 1989, HEAF entered into a revolving line of credit with Student Loan Marketing Association totaling $400,000,000 which may be utilized through December 28, 1990.

HEAF

Higher Education Assistance Foundation
Suite 500
85 East Seventh Place
Saint Paul Minnesota 55101-2173
612-227-7661

A member of the HEAF group

August 3, 1990

Ms. Roberta B. Dunn
Deputy Assistant Secretary
for Student Financial Assistance
U.S. Department of Education
7th and D Streets, S.W., Room 4624
Washington, D.C. 20202

Dear Dr. Dunn:

The information which follows is in response to your memorandum of August 2, 1990, requesting certain portfolio and financial information. The information provided is as of June 30, 1990.

HEAF Information

I.		(In 000's)
	Total Active Loans Guaranteed as of 6/30/90	$9,603,168
	Total Loans in Repayment Status as of 6/30/90	$7,197,287
	Total Loans in In-School Status as of 6/30/90	$2,405,881

In using the above data, please note that the dollar values indicated represent the original principal of the loans in each category. As a guarantor, HEAF is not in possession of repayment data which establishes the current balances of loans in repayment status. Such information is only available from lenders or servicers of the loans.

Also note that the loans described as being in an in-school status include those currently in the grace period.

I.

In Repayment Portfolio
Original Balance of Guaranteed Loans

Year of Guarantee	Proprietary School	2-Year School	4-Year School	Total
FY'80	7,924	18,183	150,798	176,905
FY'81	15,907	36,960	287,551	340,418
FY'82	14,372	32,382	223,264	270,018
FY'83	26,949	42,438	286,568	355,955
FY'84	59,961	51,372	382,739	494,072
FY'85	149,784	61,987	471,242	683,013
FY'86	332,324	68,665	436,870	837,859
FY'87	678,784	72,016	435,246	1,186,046
FY'88	840,037	70,284	491,946	1,402,267
FY'89	416,131	36,371	522,462	974,964
FY'90	55,601	4,412	295,237	355,250
TOTAL	2,597,774	495,070	3,983,923	7,076,767

As indicated earlier, the above amounts represent the original loan balances rather than the amounts currently outstanding.

Also note that the data is arrayed by the year the loans were guaranteed rather than the year of first payment made. While HEAF's data base includes a first payment due date for each loan, no existing report summarizes the data bases on that basis, and none could be written and run within your time requirements. Existing reports do, however, segregate the above data by loans which have been in repayment status for less than 360 days and those that have been in repayment from more than 360 days and hence are considered "mature" loans. Please let me know if such a report would be useful.

III. In-School Portfolio (All Loans Not in Repayment)

Original Loan Balance

Year of Guarantee	Proprietary	2-Year	4-Year
FY'80	111	285	4,405
FY'81	233	785	9,936
FY'82	161	491	9,141
FY'83	296	962	15,251
FY'84	1,039	1,663	26,109
FY'85	2,769	3,201	50,525
FY'86	7,169	6,086	96,793
FY'87	19,412	9,147	211,034
FY'88	52,350	23,768	430,519
FY'89	150,743	53,334	584,163
FY'90	230,804	45,516	355,251
TOTAL	465,087	145,238	1,793,127

Please note that the above data is displayed by year of guarantee rather than anticipated year of repayment start. Because of the drop-out rate for proprietary loans, serialization of loans, and borrowers enrolling/transferring between schools, we find the "anticipated graduation date" listed on loan applications highly unreliable as a predictor of when repayment will actually begin.

Again, our data base does contain the anticipated graduation date for each borrower/loan. Since no operating reports utilize this data, however, we can provide it only outside the timelines required by your memo.

IV. Operating Statistics

Attached please find a summary table of HEAF's "Mature Paper" default rate for each year of guarantee by the three school sectors. Enclosed please find a detailed explanation of how HEAF measures "Mature Paper" default rates and how that methodology compares to other methods.

Absent more detailed guidance, we are not certain of how to calculate a "net default rate" to meet your requirements. A direct answer would be that HEAF has a twelve-year history of recovering 34.6% of all defaults in the three to four years following payment of claims. Thus you may want to simply discount the mature paper default rates by that factor.

With regard to collection costs, we also require further guidance as to how those costs are to be defined. The information we need is how to attribute indirect costs (space, computer services, etc.) and what--if any--overhead charges should be allocated to our collections effort. Again, a direct measure might be that our average collection agency commission rate plus legal costs approximate 23.9% of recoveries.

V. Financial Summary

Enclosed please find a copy of our audited financial statements for the year-ended September 30, 1989. HEAF does not publish interim financial data because of the "seasonal" nature of major revenue and expense items in the guarantee operation.

I trust the information provided is responsive to your needs. If you have any questions, please call Val Vikmanis at (612) 693-3847.

Sincerely,

Garry D. Hays
President

GDH/lkb

Enclosure

MATURE PAPER HISTORICAL DEFAULT RATES

TOTAL COMPANY

YEAR OF ORIGINATION	SCHOOL TYPE	MATURED LOANS NUMBER	MATURED LOANS DOLLARS	DEFAULT CLAIMS NUMBER	DEFAULT CLAIMS DOLLARS	PERCENTAGE CLAIMS TO MATURE NUMBER	PERCENTAGE CLAIMS TO MATURE DOLLARS
'79 & PRIOR	4 YR	86,695	170,702,939	13,008	23,811,731	15.0%	13.9%
	2 YR	22,594	32,942,925	5,569	8,071,016	24.6%	24.5%
	PROP	12,279	18,684,867	4,079	5,940,670	33.2%	31.8%
	COMB	121,568	222,330,731	22,656	37,823,417	18.6%	17.0%
'80	4 YR	95,005	210,415,103	12,579	26,173,518	13.2%	12.4%
	2 YR	19,976	32,740,850	4,550	7,365,707	22.8%	22.5%
	PROP	10,144	18,577,227	3,623	6,661,356	35.7%	35.9%
	COMB	125,125	261,733,180	20,752	40,200,581	16.6%	15.4%
'81	4 YR	170,534	395,693,798	23,671	51,875,564	13.9%	13.1%
	2 YR	36,500	66,828,152	9,716	17,747,901	26.6%	26.6%
	PROP	19,038	38,073,171	7,700	15,150,589	40.4%	39.8%
	COMB	226,072	500,595,121	41,087	84,774,054	18.2%	16.9%
'82	4 YR	133,679	310,242,861	20,696	46,250,177	15.5%	14.9%
	2 YR	32,870	61,950,584	10,059	18,747,563	30.6%	30.3%
	PROP	18,624	39,397,988	8,560	17,528,374	46.0%	44.5%
	COMB	185,173	411,591,433	39,315	82,526,114	21.2%	20.1%
'83	4 YR	170,298	401,801,195	30,257	67,734,702	17.8%	16.9%
	2 YR	41,566	78,971,505	13,580	25,543,652	32.7%	32.3%
	PROP	31,103	69,197,404	15,037	32,904,112	48.3%	47.6%
	COMB	242,967	549,970,104	58,874	126,182,466	24.2%	22.9%
'84	4 YR	211,056	517,814,742	35,645	81,342,847	16.9%	15.7%
	2 YR	47,345	90,859,990	15,643	29,569,640	33.0%	32.5%
	PROP	75,467	170,621,683	42,932	96,182,676	56.9%	56.4%
	COMB	333,868	779,296,415	94,220	207,095,163	28.2%	26.6%
'85	4 YR	247,840	613,873,762	38,063	85,007,824	15.4%	13.8%
	2 YR	53,408	103,071,327	17,324	32,680,499	32.4%	31.7%

MATURE PAPER HISTORICAL DEFAULT RATES

TOTAL COMPANY

YEAR OF ORIGINATION	SCHOOL TYPE	MATURED LOANS		DEFAULT CLAIMS		PERCENTAGE CLAIMS TO MATURE	
		NUMBER	DOLLARS	NUMBER	DOLLARS	NUMBER	DOLLARS
	PROP	181,063	415,949,109	105,975	241,852,335	58.5%	58.1%
	COMB	482,311	1,132,894,198	161,362	359,540,658	33.5%	31.7%
'85 ITD	4 YR	1,115,107	2,620,544,400	173,919	382,196,363	15.6%	14.6%
	2 YR	254,259	467,365,333	76,441	139,725,978	30.1%	29.9%
	PROP	347,718	770,501,449	187,906	416,220,112	54.0%	54.0%
	COMB	1,717,084	3,858,411,182	438,266	938,142,453	25.5%	24.3%
'86	4 YR	229,078	556,749,007	32,177	69,866,973	14.0%	12.5%
	2 YR	56,122	108,731,815	17,337	32,741,584	30.9%	30.1%
	PROP	345,405	787,377,308	183,578	417,819,091	53.1%	53.1%
	COMB	630,605	1,452,858,130	233,092	520,427,648	37.0%	35.8%
'86 ITD	4 YR	1,344,185	3,177,293,407	206,096	452,063,336	15.3%	14.2%
	2 YR	310,381	576,097,148	93,778	172,467,562	30.2%	29.9%
	PROP	693,123	1,557,878,757	371,484	834,039,203	53.6%	53.5%
	COMB	2,347,689	5,311,269,312	671,358	1,458,570,101	28.6%	27.5%
'87	4 YR	204,267	536,837,177	23,602	52,271,705	11.6%	9.7%
	2 YR	53,667	105,755,354	14,071	27,552,249	26.2%	26.1%
	PROP	544,724	1,267,462,254	236,875	543,386,408	43.5%	42.9%
	COMB	802,658	1,910,054,785	274,548	623,210,362	34.2%	32.6%
'88	4 YR	176,617	568,130,070	15,303	37,161,243	8.7%	6.5%
	2 YR	48,090	98,078,997	10,568	22,402,334	22.0%	22.8%
	PROP	594,862	1,459,787,956	229,089	564,028,075	38.5%	38.6%
	COMB	819,569	2,125,997,023	254,960	623,591,652	31.1%	29.3%
'88 ITD	4 YR	1,725,069	4,282,260,654	245,001	541,496,284	14.2%	12.6%
	2 YR	412,138	779,931,499	118,417	222,422,145	28.7%	28.5%
	PROP	1,832,709	4,285,128,967	837,448	1,941,453,686	45.7%	45.3%
	COMB	3,969,916	9,347,321,120	1,200,866	2,705,372,115	30.2%	28.9%